Whose Claim Is This Anyway? Third-Party Litigation Funding

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Article

Whose Claim Is This Anyway? Third-Party Litigation Funding

Maya Steinitz†

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INTRODUCTION

Imagine that a woman wants to bring a claim for sexual harassment against her powerful and wealthy former employer but can neither afford counsel nor find an attorney willing to take the case on contingency. A private funder provides the necessary financing for her to pursue her claim. Further suppose that the employer in question is a former governor, now the sitting President of the United States, and that the investor is a wealthy supporter of the President’s political opposition, and that the case starts a chain reaction that could have brought an end to the President’s term in office.¹

¹ This is, of course, the Paula Jones case against Bill Clinton. See Clinton v. Jones, 520 U.S. 681 (1997); Jones v. Clinton, 72 F.3d 1354 (8th Cir. 1996). On the funding and possible instigation of the claim by a right-wing businessman, see Jay Branegan, Paula Jones: Case Dismissed, TIME.COM (Apr. 1, 1998), http://www.time.com/time/community/transcripts/CHATTR040198.html. I thank Henry Hansmann for bringing this example to my attention.
Now imagine a group of indigent villagers in Angola, whose village has been subject to a negligent and lethal chemical spill at the hands of the agents of a multinational corporation based in the United States. The cover-up involves spying on, intimidating, and even murdering locals. Unable to afford a suit on their own, an investment company funds their attempt to seek redress through an expensive, protracted, and complex Alien Tort Claims Act claim filed in a U.S. court.

Imagine also a corporation that is facing a bet-the-company class action lawsuit, which it is convinced is a strike-suit (i.e., a nonmeritorious but prohibitively expensive suit to defend). Facing the risk of an uncertain jury verdict, it transfers that risk to a third party by paying a premium. Thus protected, it enables itself to continue its smooth operation generating profits for its shareholders and jobs for its employees.

Contemplate, if you will, an oil company funding a developing country’s claim in a boundary dispute. The dispute over territory rich with petroleum is being decided in an international arbitration—a confidential and, therefore, nontransparent process to which even the citizens of the countries whose boundaries are in dispute have no access. Further envision that the developing country has no funds of its own and would otherwise be unable to mount a competent defense of its claim to the territory.

Finally, suppose that the China Investment Corporation (CIC), China’s Sovereign Wealth Fund, funds a suit against an American company in a sensitive industry such as military technology. In the process of conducting due diligence prior to its investment in the litigation, as well as in connection with its ongoing monitoring of the litigation in which it now has a legal stake, CIC obtains highly confidential documents containing proprietary information regarding sensitive technologies from the American defendant-corporation.

What do all of these scenarios—some uplifting, some foreboding—have in common? The answer is that they would all be made possible by a group of practices that are coming to be known as third-party litigation funding. Litigation funding, still in its infancy but steadily growing, is one of the most sig-

nificant developments in civil litigation today. It represents a
potential sea change in the character and policy implications of
litigation in the United States. Litigation funding affects
numerous areas of the law including corporate law (securities,
antitrust, and all manner of corporate defense), intellectual
property, tort law, environmental law, employment law, human
rights law, and international law. Taking into account the in-
dustry’s ascendance overseas and its foothold in the United
States, it behooves us to examine the effects third-party litiga-
tion funding will have on the American legal system.

Litigation finance in the United States is in its infancy,
however. On the one hand, economic forces are propelling its
expansion, while, on the other, prohibitive regulation bars its
usage in most states. The economic forces, discussed in more
detail below, include competitive pressures on U.S.-based in-
ternational law firms by non-U.S.-based international law
firms that can avail themselves of such funding, the effects of
the recent global recession, and the convergence of a number of
long-standing trends relating to law-firm finance. The outdated
ethics regulation, predominantly in the form of the doctrine of
champerty—the prohibition on dividing litigation proceeds be-
tween a party and a non-party who supports the legal action—
and the prohibition on fee splitting with nonlawyers, casts se-
rious doubt on the legality of the practice in most, if not all,
states.

As the examples above illustrate and this Article will ex-
plain, the effect will differ depending on a combination of who
is doing the funding, who is receiving the funding, and the sub-
ject matter of the dispute involved. The examples are also evoc-
ative of the fact, identified and analyzed in this Article, that lit-
igation funding may do more than just the obvious (i.e.,
facilitate access to justice). By aligning structurally weak social
players who make infrequent use of the courts (one-shotters)
with powerful funders who make repeated use of the court sys-

4. See Third Party Litigation Funding and Claim Transfer, RAND
9, 2011) (identifying third-party litigation funding as one of the “biggest and most in-
fuential trends in civil justice”).

5. See infra Part II (discussing the state of the law of champerty and fee
splitting).
serve as a redistributive tool by society's have-nots as opposed to an (unwitting, perhaps) guardian of the status quo in favor of society's haves. In other words, it may allow these traditionally disempowered parties to "play for rules," i.e., to affect the content of legal rules determined by the courts. This Article will further argue that these beneficial effects could be offset by two factors: (1) the development of secondary markets in legal claims, and (2) the fragmentation of the attorney-client-funder relationship under the rules of professional responsibility into two separate relationships between attorney and client and between client and funder. Both factors offset the potential beneficial effects by creating agency problems. Those offsetting factors, however, can be managed by a sufficiently nuanced regulatory scheme, the outline of which this Article will proffer.

While a handful of scholars have written about litigation lending, a precursor of litigation finance, this Article describes...
the empirical reality of institutional investing in litigation in the United States, identifies and addresses the prospect of securitization of legal claims, and discusses third-party funding of international arbitration. It also applies a bargaining analysis to the debate on the desirability of any type of litigation finance or lending.

Part I of this Article will provide the background necessary to place the new industry in context, including a description of the first and second waves of litigation funding, current market forces driving the development of the latter industry, the accelerating effects of the global recession that began in 2007, and a discussion of litigation funding in the foreign jurisdictions that permit it—predominantly, Australia and the United Kingdom.

Part II will explore the doctrinal landscape that controls and limits litigation funding in the United States. Together, the law of champerty and the prohibition on attorneys sharing fees with non-attorneys comprise a prohibition on litigation funding. A particular emphasis will be given to the policy rationales underlying these prohibitions. In addition, and by way of contrast to the prohibition on litigation funding, this Part will explore some areas of law in which claim transfer and litigation funding are allowed, albeit with certain conditions and limitations. These are, first and foremost, the areas of contingency fees and insurance law, but also, secondarily, areas such as qui tam laws, the law of assignment, and bankruptcy. Part II will conclude by showing that the blanket prohibition of champerty and entrepreneurial model" of aggregate litigation (class action) in Europe. Forthcoming discussions on litigation finance include Anthony J. Sebok, The Inauthentic Claim, 64 VAND. L. REV. (forthcoming 2011), available at http://ssrn.com/abstract_id=1593329, and Stephen C. Yeazell, Transparency for Civil Settlements: NASDAQ for Lawsuits?, in TRANSPARENCY IN THE CIVIL JUSTICE SYSTEM (Joseph Doherty & Robert Reville eds., forthcoming 2011), available at http://ssrn.com/abstract_id=1161343 (advocating for greater transparency regarding settlements of civil claims). Yeazell, a historian and theorist of civil litigation, has previously argued that the most important phenomena of modern litigation are best understood as results of changes in the financing and capitalization of the bar. Stephen C. Yeazell, Re-Financing Civil Litigation, 51 DEPAUL L. REV. 183, 183 (2001). There is also some literature in Australia and the United Kingdom discussing litigation finance as it occurs in those jurisdictions. See, e.g., VICKI WAYE, TRADING IN LEGAL CLAIMS: LAW, POLICY & FUTURE DIRECTIONS IN AUSTRALIA, UK & US (2008); Lee Aitken, Before the High Court: 'Litigation Lending' After Fostif, 28 SYDNEY L. REV. 171 (2006); John Peysner, A Revolution by Degrees: From Costs to Financing and the End of the Indemnity Principle, 1 WEB J. CURRENT LEGAL ISSUES (2001), http://webjcli.ncl.ac.uk/2001/issue1/rtf/peysner1.rtf. However, the applicability of the Australian and English experience and especially the policy considerations for and against litigation finance is limited. See infra note 23.
fee splitting contributes to the very type of systemic inequities it was intended to avoid.

Next, this Article will show how litigation funding can reduce those systemic inequities, though not without attendant dangers. To set the stage, Part III will open with a taxonomy of the dimensions of litigation relevant to the consideration of the effects of third-party funding—the types of clients, claims, and funders. Using a bargaining perspective, the remainder of Part III will then argue that litigation funding can (1) level the playing field by strengthening the bargaining position of have-nots and increasing their ability to play for rule change while limiting (to an extent) the ability of the haves to do so, and (2) create agency problems that vary greatly depending on the client-claim-funder combination in play. Therefore, any attempt to capture the equalizing benefits of third-party financing of litigation must rest on a nuanced regulatory scheme sensitive to the distinct requirements of different taxonomical combinations.

Part IV will then provide a five-pronged regulatory framework, with concrete examples, that harnesses the positive potential of litigation funding while addressing the problems it might create if left unchecked. The five prongs are (1) eliminate the champerty prohibition, at least as it relates to litigation funding; (2) reform the attorney-client-funder relationship, including by extending some of the protections and duties of the attorney-client relationship to the funder-client relationship,

limiting the prohibition on fee sharing to allow attorneys to contract directly with the funders, and allowing and encouraging fee structures that align the three parties’ interests; (3) apply consumer-protection and contract-design principles to funding agreements; (4) require court supervision over the attorney-client-funder relationship; and (5) tailor securities regulation to legal-claims-backed securities.

This Article is aimed at two main audiences. One consists of legislators, regulators, and courts, all of whom will, no doubt, be called on in the coming years to decide on the legality and parameters of the practices comprising third-party litigation funding. The second consists of parties who are contemplating entering such funding agreements and the attorneys who represent them. This audience will benefit from the elucidation of the issues they should consider when drafting such agreements.

I. THE RISE OF LITIGATION FINANCE

This Part defines the term “third-party litigation funding,” as used herein, and provides the key characteristics of the industry to which it refers. It distinguishes litigation finance from similar and overlapping practices, such as litigation lending, by identifying its distinctive features. This includes the key feature that distinguishes it from analogous practices such as contingency fees—the industry’s ability and tendency to develop secondary markets in legal claims. This Part also explains the origins of the industry in the United Kingdom and Australia, touching on key legal developments that rendered the practice permissible, with certain restrictions, in those jurisdictions. It then describes how those changes overseas, coupled with the ongoing recession, are creating market forces that drive the penetration of litigation funding into the United States. All these set the stage for the normative discussion of the desirable legal regime for litigation funding in subsequent Parts.

A. LITIGATION FINANCE DEFINED

Third-party litigation funding is “a group of funding methods that rely on funds from the insurance markets or capital

9. This Part is informed by twelve not-for-attribution background interviews with executives of litigation-funding firms and attorneys who have utilized litigation finance.
markets instead of, or in addition to, a litigant’s own funds.”

In other words, it is the provision of funds by companies who have no other connection with the litigation. When provided to plaintiffs, third-party funding promotes access to justice by enabling plaintiffs who have meritorious cases to bring litigation they would otherwise be unable to bring and to avoid premature settlements at a discount due to the exhaustion of funds. When provided to defendants, it allows corporations who can afford to litigate but who do not want to incur any of the costs or risks associated with litigation to shift the costs and hedge the risks.

The typical funding arrangement has been described by one of the major international law firms as one whereby a specialist funding company or a hedge fund... pay[s] the lawyers' fees on an interim basis.... If you win, you pay a contingency fee out of the damages, usually expressed as a percentage of the damages up to an agreed cap. A typical contingency fee would be between twenty and fifty percent of the damages, with a cap of three to four times the legal costs advanced by the funder.

Importantly, the client contracts directly with the funder in these agreements. However, informal agreements between the funder and the attorney are at times involved. Also critical to the viability of the industry’s business model in the United States is that funders leverage their emerging relationships with law firms to negotiate reduced contingencies, reduced hourly rates, flat fees, or some combination of the aforesaid. Given that these funders thus far are run by former lawyers who are familiar with but disconnected from the inefficiencies of the law firm, they provide monitoring services. As expe-

13. See id.
14. Id.
15. See id.
16. See Jonathan Wheeler & Felicity Potter, Welcome to the Party, 158 NEW L.J. 1491, 1491 (2008) (“The funder is also likely to demand, as much as anything as a sign of faith in the merits of the case on the part of the claimant's lawyers, that the claimant's solicitors enter into a discounted conditional fee agreement whereby the solicitors charge perhaps 70% of their usual costs but are entitled to an uplift in the event of success.”).
17. See Martin, Litigation Financing, supra note 7, at 90.
rienced former attorneys, they may also have an edge in case selection.

The new industry, referred to herein as “second-wave litigation funding,” is populated by institutional investors including some very prominent and sophisticated firms such as the leading Swiss bank, Credit Suisse, and the German insurance giant, Allianz.18 It was preceded, however, by approximately a decade in which smaller, less reputable firms launched litigation-lending businesses, a practice referred to herein as “first-wave litigation funding.” These were often relatively small operations set up by former contingency fee lawyers who recognized the demand for such lending services and oftentimes engaged in predatory lending. As such, first-wave litigation funding has been regarded by some as a form of subprime lending.19

Whereas it was traditionally individual plaintiffs who resorted to third-party funding, often in personal injury cases, the recent trend is aimed at very different markets: corporate litigants, including corporate defendants, classes (in class action cases), and individual plaintiffs in non-personal injury cases. There is a particular push for litigation funding in international arbitration where, at times, the funded party may be a sovereign entity.20 In international arbitrations, the reason for

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20. See Telis Demos, Cashing in on Litigation, FORTUNE, May 11, 2009, at 20, 20 (“Juridica gives money to Fortune 500-size companies or their lawyers in the early stages of corporate lawsuits in exchange for a share of the payout if the plaintiffs win or settle.”); Herman, supra note 18 (“A closer look at the litigation funds operating in the London market... reveals that they are seeking to invest in commercial rather than personal disputes.”); Gillian Lemaire, Costs in International Commercial Arbitration: The Case for Predictability, COM. DISP. RESOL., Mar. 12, 2009, http://www.cdr-news.com/expert-views/101-costs-in-international-commercial-arbitration-the-case-for-predictability (“Specialist litigation funds, frequently institutional investors, have become more common in certain countries and although investment is made more frequently in litigation, it is now becoming increasingly common in international arbitration cas-
this expansion is partly a de facto absence of professional regulations that enables funders and attorneys to operate outside of the disciplinary reach of bar associations. On the defense side, there is a market gap as contingency fee arrangements are inapplicable to defendants who need to transfer not only the cost of legal fees and litigation expenses, as do plaintiffs, but also of judgments and settlements. So, while attorney funding and third-party funding of individual and class claims are not unprecedented, funding of corporate defendants and international arbitrations is a new phenomenon.

B. GLOBAL ECONOMIC MARKET FORCES PROPELLING THE RISE OF LITIGATION FINANCE

1. Competitive Pressures from Litigation Funding in Foreign Jurisdictions

The pressures driving the emergence of a new market in legal claims and defenses in the United States, despite a hostile regulatory environment, can only be understood in a global context. A few foreign jurisdictions, predominantly Australia and the United Kingdom, have taken progressive strides in the past fifteen years to loosen or abolish long-standing champerty restrictions and to develop markets for third-party funding. There is also the beginning of a discourse on allowing the same in Europe.

es. Indeed, some third party funders are now believed to target international arbitrations for investment (“Although this funding method has been traditionally popular on the claimant’s side, a handful of major companies are now trying to defend high-stakes litigation with third-party funding.”). 21. On the lack of de facto regulation of lawyers engaged in cross-border litigation, see Maya Steinitz, *Internationalized Pro Bono and a New Global Role for Lawyers in the 21st Century: Lessons from Nation-Building in Southern Sudan*, 12 YALE HUM. RTS. & DEV. L.J. 205, 211–15 (2009). On the market gap in litigation-defense finance, see Molot, supra note 7, at 377.

23. The developments in the United Kingdom and in Australia must be viewed in light of the fact that both jurisdictions are governed by the so-called British rule which requires the losing party to pay the winner’s attorneys’ fees. Conversely, the American rule requires that each party bear its own fees. This means access to justice is more limited in British rule jurisdictions as the rule leads to less litigation, including less meritorious litigation. See John F. Vargo, *The American Rule on Attorney Fee Allocation: The Injured Person’s Access to Justice*, 42 AM. U. L. REV. 1567, 1635–36 (1993). Also, in both Australia and the United Kingdom the legal availability of contingency fees (fees in which the attorney gets a share of the judgment) is much more limited, and takes the
In Australia, where third-party litigation funding was initially permitted in the bankruptcy context and later gained acceptance in civil litigation generally, litigation funding has been a feature of litigation for more than a decade. Australian courts, like courts in the rest of the common-law world, have historically prohibited litigation funding. But “[t]he Australian courts have demonstrated in their decisions and in obiter commentary that public policy is changing, and that it is no longer taboo for a party who provides funding for a case, to have a legitimate commercial interest in the outcome.” Similarly, Australian legislatures have begun to adopt a liberal stance on litigation funding by relaxing champerty restrictions through legislative action.

In joint landmark cases on this issue, Campbells Cash and Carry Pty. Ltd. v Fostif Pty. Ltd. and Mobil Oil Australia Pty. Ltd. v Trendlen Pty. Ltd., the Australian High Court permitted third-party funding with the funder having broad powers to control the litigation. Fostif involved a litigation funder who sought to fund a litigation allowing small tobacco retailers to recover license fees from wholesalers. The third-party funder actively searched for and propositioned potential plaintiffs in the case. Importantly, the funding agreement permitted the funder to conduct representative proceedings, choose the attorney (who regarded the funder as its client), and settle with the form of a conditional fee (fees in which the lawyer gets a premium if the case is won, which is unrelated to the adjudicated amount), further restricting access to justice as compared with the United States. See Winand Emons & Nuno Garoupa, U.S.-Style Contingent Fees and U.K.-Style Conditional Fees: Agency Problems and the Supply of Legal Services, 27 MANAGERIAL & DECISION ECON. 379, 379–80 (2006). On the European discourse generally, see CHRISTOPHER HODGES, THE REFORM OF CLASS AND REPRESENTATIVE ACTIONS IN EUROPEAN LEGAL SYSTEMS: A NEW FRAMEWORK FOR COLLECTIVE REDRESS IN EUROPE (2008), and Coffee, supra note 7, at 340–42, which suggests a “non-entrepreneurial model” of aggregate litigation for Europe where the American entrepreneurial model, including the contingent fee and the American rule regarding costs, has long been resisted.

24. See Aitken, supra note 7, at 172–74.
26. See Aitken, supra note 7, at 174.
29. Fostif, 229 CLR at 413.
30. See id.
defendants for seventy-five percent of the amount claimed.\textsuperscript{31} Per the agreement, the funder paid all associated costs and was to receive thirty-three percent of any recovered amount as well as cost awards.\textsuperscript{32}

Recognizing the various concerns in question, the court stressed, on the one hand, the value provided by access to funding and the funder's need to have some measure of control over the litigation while, on the other, stating that court supervision, ethics rules, and rules governing representative proceedings mitigated the traditional dangers posed by third-party funding.\textsuperscript{33} The court, in a nod to freedom-of-contract concerns, also noted that it was hesitant to interfere with funding agreements when entered into by persons of "full age and capacity . . . untainted by infirmity."\textsuperscript{34} The \textit{Fostif} case provided much needed certainty to the status of litigation funding in Australia. Moreover, as recently as October 2009, the Australian High Court has interpreted its decision in \textit{Fostif} to be a ban on any general rule prohibiting the funding of litigation for reward.\textsuperscript{35}

Following closely in the footsteps of Australia is England. It too took legislative steps to amend champerty laws. The Criminal Law Act of 1967 abolished criminal and civil liability for champerty, but the legislation did not "affect any rule of law as to the cases in which a contract is to be treated as contrary to public policy or otherwise illegal."\textsuperscript{36} English courts embraced

\begin{footnotesize}
\begin{enumerate}
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\item See \textit{id.}  \\
\item \textit{Id.}  \\
\item \textit{Id.} at 435–36 ("The solution to [the] problem [of the high cost of litigation] (if there is one) does not lie in treating actions financially supported by third parties differently from other actions. And if there is a particular aspect of the problem that is to be observed principally in actions where a plaintiff represents others, that is a problem to be solved, in the first instance, through the procedures that are employed in that kind of action. It is not to be solved by identifying some general rule of public policy that a defendant may invoke to prevent determination of the claims that are made against that defendant." (emphasis added)).  \\
\item Id. at 434–35.  \\
\item See \textit{Jeffery & Katauskas Pty. Ltd. v SST Consulting Pty. Ltd.} (2009) 239 CLR 75, 92 (Austl.) (addressing the issue of indemnity for costs by litigation funders).  \\
\item Criminal Law Act, 1967, c. 58, § 14 (Eng.). Despite Australia's progressive attitude toward litigation funding, it must be noted that a recent, and controversial, Federal Court ruling has led to considerable confusion regarding the legality of this practice. On October 20, 2009, the Federal Court ruled that litigation funding was regulated by the Corporations Act of 2001. \textit{Brookfield Multiplex Ltd. v Int'l Litig. Funding Partners Pte. Ltd.} (2009) 180 FCR 11, 33, 37–38 (Austl.). Pursuant to the Act, private litigation funders would be required to hold an Australian Financial Services license before offering funding
\end{enumerate}
\end{footnotesize}
the legislative changes to champerty law in a progressive manner, and readily admitted that champerty law must evolve over time to reflect changing views of public policy. The qualified limitation of champerty restrictions permitted English courts to act with a great deal of discretion, but it left observers and potential funders of litigation with some uncertainty.

The most dramatic legal development for the litigation-funding industry came in 2005 in the form of a decision by the English Court of Appeal in Arkin v. Borchard Lines Ltd. In that case, the Court of Appeal held that, while third-party funding is acceptable and even desirable as a way of increasing access to justice, the funder does not control the management of the litigation:

The approach that we are about to commend will not be appropriate in the case of a funding agreement that falls foul of the policy considerations that render an agreement chamertous. . . . Our approach is designed to cater for the commercial funder who is financing part of the costs of the litigation in a manner which facilitates access to justice and which is not otherwise objectionable. Such funding will leave the claimant as the party primarily interested in the result of the litigation and the party in control of the conduct of the litigation.

Consequently, international law firms based in the United Kingdom began utilizing litigation funding or seriously considering doing so, thereby creating competitive pressures on their competitors based in the United States. As of March 2008, "[e]ight out of 10 of London's top law firms [were] already using or assessing external funding for litigation and arbitration cases, . . . marking a dramatic move of third-party funding into mainstream practice . . . .' Even [the U.S.-based firm] Skadden [was] getting into the action, reportedly using third-party funding in an arbitration case."
In sum, these advancements have chipped away at the doctrine of champerty, at least as it pertains to third-party funding, and have created a global environment in which some jurisdictions enable litigants, including multinational litigants who can comparison shop among international law firms, to make use of litigation finance.

2. Creation of a Secondary Market in Legal Claims

The rise of the litigation-funding industry (i.e., a primary market in legal claims) had an additional effect besides competitive pressures on global law firms. The last couple of years have also ushered in a secondary market in legal claims. Predominantly, this secondary market takes the form of litigation-funding firms going public—selling shares to the public and listing on stock exchanges. But it is possible that in the foreseeable future we will also be witnessing the creation of a new form of securities—legal-claims-backed securities. Reportedly, some tort-litigation lenders are already in the practice of aggregating the claims they acquire and selling shares of the composite funds; that is, they are engaged in a rudimentary form of securitization. Further support of the proposition that securitization of this new asset class, namely legal claims and defenses, may be forthcoming in the near future can be gleaned from the fact that the first wave of litigation funding also generated a smattering of similar secondary trading in legal claims. A few lawsuits were syndicated during the 1980s, with some instances of syndication ending up in litigation.


42. See Hananel & Staubitz, supra note 7, at 796–97.

43. See In re “Agent Orange” Prod. Liab. Litig., 818 F.2d 216, 217 (2d Cir. 1987).
have been traded on Nasdaq. The existence of a secondary market in litigation claims, which is poised to grow, is the key feature distinguishing not only the second wave of litigation funding from the first, but also, as we shall see, third-party funding from attorney-funding of litigation (the contingency fee).

3. Effects of the Global Recession on the Rising Demand for Litigation Funding

The global context fueling demand for third-party litigation funding also includes the global economic crisis. Companies are increasingly cautious about expending the costs of litigation. The crisis has also given rise to an increased volume of legal disputes regarding the legality of numerous practices that caused the crisis. Otherwise stated, recessions, including the current one, produce more claimants who possess less funding for, or at least less appetite to bear, litigation costs.

Additionally, in the aftermath of the crisis, institutional investors are looking for new types of investments that are untainted by some of the problems which led to the crisis, or that at least can be marketed as such to their own investors. As a new asset class, legal claims provide just that. Moreover, legal

44. Margaret Cronin Fisk, ‘Winstar’ Litigants Bet on Future Damages Awards, NAT’L L.J., Jan. 11, 1999, at A19 (“Several savings and loan institutions involved in the Winstar litigation are selling shares in possible judgments on the Nasdaq stock exchange. . . . In the past, other banks had established trusts for shareholders, assigning them contingent rights in litigation[,] . . . [but] ‘this was rare, and you couldn’t buy or sell these rights.’” (quoting Victor Lewkow, partner, Cleary, Gottlieb, Steen & Hamilton LLP)). Interviews with executives in litigation investing firms also confirm that securitization is being considered. The report on the Winstar litigation gives a peek at how courtroom developments and judges’ decisions may affect the value of stock linked to litigation:

The price of the [] shares rose in late October after Congress passed the 1999 federal budget, approving funds to pay the [] claims. But in mid-November, when U.S. Claims Court Judge Robert H. Hodges ruled that Cal Fed would not be able to recover damages under its ‘expectations’ theory, the price of one Cal Fed litigation stock dropped 25%, while the other declined 20%.

Id.

45. See Jonathan D. Glater, Billable Hours Giving Ground at Law Firms, N.Y. TIMES, Jan. 30, 2009, at A1, available at 2009 WLNR 1784153 (“Clients are more concerned about the budgets, more so than perhaps a year or two ago.”) (quoting Evan R. Chester, presiding partner, Cravath, Swain & Moore LLP).

46. See BAKER & MCKENZIE LLP, supra note 10 (“[T]he sub-prime crisis in the US is leading to an increased volume of underlying litigation in an effort to apportion blame—and with it, legal liability.”).
claims are an asset class that is "not cyclically correlated with bonds and equities."\textsuperscript{47} For these very reasons in fact, litigation is often viewed by large firms—and now by investors—as a counter-cyclical practice; litigation departments are maintained by corporate law firms to a large extent for diversification purposes.\textsuperscript{48}

The global recession is also accelerating the ascendance of "alternative fee structures" as a substitute to the billable hour.\textsuperscript{49} Litigation funding represents one such alternative modality. Instead of costly legal bills based on hours worked, clients can shift the costs entirely onto investors.\textsuperscript{50} And law firms face the prospect of easier collection from funders, whose very investment consists of paying the firms’ bills, rather than a struggle to collect the fees owed them from clients reeling from the recession.

The "incorporation movement"—changes in the laws of some jurisdictions which allow investment in law firms—is another development that is part of the environment.\textsuperscript{51} Major law firms that in the past would not have considered "brokering" litigation funding for their clients are increasingly doing so or considering doing so.\textsuperscript{52} Like clients’ increasing resistance to the billable hour, this development creates pressure on attorneys’ traditional pricing models.\textsuperscript{53} Another related feature of contemporary law-firm finance that may come to affect the trend is that law firms can establish separate legal entities

\begin{footnotesize}
47. See id.
48. See id.; cf. Binham, supra note 41 (“[C]ommercial litigation is poised to take off if the economy takes a nosedive. As Fields said: ‘our business model is fairly recession-proof.’” (quoting Richard Fields, co-founder, Juridica Capital Management)).
49. See generally Glater, supra note 45 (discussing the likelihood of alternative billing).
50. See BAKER & MCKENZIE LLP, supra note 10 (“If you lose, the funding company will pay the winning party’s costs.”).
\end{footnotesize}
that function exclusively as funding firms and direct funding business to that particular law firm.\textsuperscript{54}

These economic forces and the burgeoning international litigation-finance industry are met with legal barriers in the form of restrictive ethical rules that limit both the industry's growth globally and, in particular, its penetration into the United States. In addition, these prohibitions create uncertainty which raises the costs of litigation finance, i.e., the costs clients have to pay to secure such funding. The two main legal impediments to litigation funding are the doctrine of champerty and the prohibition on attorney fee sharing with nonlawyers.\textsuperscript{55} These will be discussed in turn.

\textsuperscript{54} This has been the solution to restrictions on other kinds of "multidisciplinary practices," defined as the practice of both law and a related discipline, such as accounting or private investigations under one roof, which is prohibited by most states. \textit{See Jay S. Zimmerman & Matthew J. Kelly, From the Trenches and Towers: MDPs After Enron/Andersen, 29 LAW & SOC. INQUIRY 639, 644–47 (2004) (discussing the barriers imposed by ABA Model Rule 5.4—which limits a lawyer's ability to run a business with a nonlawyer—and the rise of subsidiary businesses of law firms); see also Stacy L. Brustin, \textit{Legal Services Provision Through Multidisciplinary Practice}, 73 U. COLO. L. REV. 787, 799–821 (2002) (same with regard to the nonprofit sector). There is at least one reported instance of such a practice: Richard Fields and Timothy Scrantom are co-principals of both Juridica's investment arm and of the law firm of Fields & Scrantom, one of the firms to which Juridica will supply indirect investment in cases where plaintiffs either cannot have, or do not want, direct investment. \textit{See Binham, supra note 41.}

\textsuperscript{55} \textit{See, e.g., MODEL RULES OF PROF'L CONDUCT R. 5.4(a) (2010) ("A lawyer or law firm shall not share legal fees with a nonlawyer.").} A secondary barrier is the prohibition on usury, which has largely been eliminated. Courts that have had the opportunity to review such challenges to a funding agreement as usurious have largely dismissed such challenges given that an element of usury is that a lender can require the borrower to return the loan, whereas funding agreements are nonrecourse agreements. \textit{See, e.g., Anglo-Dutch Petroleum Int'l, Inc. v. Haskell, 193 S.W.3d 87, 95–101 (Tex. Ct. App. 2006) (holding usury laws inapplicable because the repayment was contingent only upon victory in the underlying suit).} Another secondary barrier is the ethical prohibition on attorney solicitation, noted below. Generally, challenges to third-party funding come to courts in one of two ways: a financed party wins, refuses to pay, and either sues for rescission of the funding agreement or is sued by the funder for breach of contract, or the opposing party gets wind of the fact of third-party funding and brings a judicial challenge to the legality of the arrangement. Courts are generally asked to invalidate these agreements on two grounds, champerty and usury. For a summary of recent cases challenging third-party funding agreements, see Martin, \textit{Litigation Financing, supra note 7, at 87–95.}
II. A PROHIBITION ON LITIGATION FINANCE: HISTORICAL ANTECEDENTS AND CONTEMPORARY EFFECTS

This Part describes the ethical standards and rules of professional responsibility which, in most states, effectively prohibit third-party funding and greatly limit the penetration of the industry into the United States. Importantly, they also contribute to the very systemic inequalities they were designed to prevent. The primary barrier is the doctrine of maintenance and champerty. A close second is the prohibition on attorney fee sharing with non-attorneys, which prohibits funders from contracting directly with attorneys. This Part places a special emphasis on examining the policy considerations underlying these restrictions as ultimately it is the policy considerations that should inform the debate on the desirable legal regime going forward. As a contrast, this Part offers some examples of areas of law in which external funding and claim transfers are permitted, with appropriate safeguards, due to overriding policy considerations. These are meant to illustrate that compelling reasons to allow litigation funding—considerations such as access to justice, private enforcement of law, and equality-of-arms—should lead our legal system to adapt and allow such practices with the appropriate regulatory safeguards. This Part concludes with an analysis of just such an overriding consideration—the weak bargaining power of entire categories of litigants and their consequent inability to play for rules the way other more powerful actors do. This analysis supports the development of the legal regime suggested herein for the litigation-finance industry.

A. MAINTENANCE AND CHAMPERTY

Champerty is defined as an “agreement to divide litigation proceeds between the owner of the litigated claim and a party unrelated to the lawsuit who supports or helps enforce the claim” or, more pejoratively, as “an agreement between an officious intermeddler in a lawsuit and a litigant by which the intermeddler helps pursue the litigant’s claim as consideration

for receiving part of any judgment proceeds.” 57 It is a form of maintenance whereby “assistance in prosecuting or defending a lawsuit [is] given to a litigant by someone who has no bona fide interest in the case.” 58 Champerty is an ancient concept with roots in Greek and Roman law that derives its name from the Old French “champart,” which was a feudal-era land grant scheme. 59

The New York Court of Errors’ 1824 case Thallhimer v. Brinckerhoff 60 reviewed the unjust social and flawed legal context that necessitated the doctrine at a time when the administration of public justice in medieval England was weak and corrupt:

[The English doctrines of maintenance and champerty arose from causes unique to English life. The [New York Court of Errors in Thallhimer] especially pointed to a statute from the 32nd year of Henry VIII, “to repress the practices of many who when they thought they had title or right to any land, for the furtherance of their pretended right, conveyed their interest in some part thereof to great persons, and with their countenance, did oppress the possessors.” . . . What had happened was that “small men” transferred their rights of action in property disputes to “great men” in order to get the great men’s support at law. Because the legal establishment was weak at the time, the great men could overwhelm the court, thus enabling the little man to get his land claim and the great men to get their share. In other words, champerty was a means by which great men increased their power at the expense of the courts of justice. 61

Interestingly, in modern American history, the doctrine of champerty has also played a role in social struggles. Specifically, it has been used to stifle social progress:

In the middle 1950’s seven southern states suddenly discovered a need to reinvigorate and extend existing champerty, maintenance and solicitation rules. The flurry of legislation came on the heels of the Supreme Court’s decision in Brown v. Board of Education in which five civil rights organizations appeared as amicus curiae. The two events were not unconnected. The action of the legislatures was a

57. BLACK’S LAW DICTIONARY 262 (9th ed. 2009).
58. Id. at 1039.
60. 3 Cow. 623 (N.Y. Sup. Ct. 1824).
61. William R. Long, Champerty and Contingent Fees Part III, DRBILLLONG.COM (Dec. 13, 2005), http://www.drbilllong.com/LegalHistoryII/ChampertyIII.html (emphasizing that where you have strong instruments of justice you do not need the doctrine; courts can oversee and disallow officious intermeddling when there is a risk that the judicial process will be perverted).
vigorous political response to the success of these organizations before the courts.62

The modern policy rationale most often cited in support of the imposition of champerty restrictions includes a desire to discourage excessive, unnecessary, or speculative litigation—often associated with third parties seeking profit, rather than redress, through suits.63 Another rationale for the restriction is a desire to prevent unfair dealings, in which a party with a dominant bargaining position is able to realize excessive profits when purchasing another party's claim.64 Perhaps the best modern articulation of the concerns underlying the champerty doctrine can be found in the concurring opinion in Fostif, the leading Australian case regarding third-party funding. In that case, the court stated:

Institutions like [the funders], which are not solicitors and employ no lawyers with a practising certificate, do not owe the same ethical duties. No solicitor could ethically have conducted the advertising campaign which [the funders] got [the plaintiff] to conduct. The basis on which [the funders] are proposing to charge is not lawfully available to solicitors. Further, organisations like [the funders] play more shadowy roles than lawyers. Their role is not revealed on the court file. Their appearance is not announced in open court. No doubt sanctions for contempt of court and abuse of process are available against them in the long run, but with much less speed and facility than is the case with legal practitioners. In short, the court is in a position to supervise litigation conducted by persons who are parties to it; it is less

62. Comment, The South's Amended Barratry Laws: An Attempt to End Group Pressure Through the Courts, 72 YALE L.J. 1613, 1613 (1963); see also Constitutional Law: First Amendment Limitations on State Regulation of the Legal Profession—Litigation as a Protected Form of Expression, 1963 DUKE L.J. 545, 545 (citing NAACP v. Button, 371 U.S. 415 (1963), for the proposition that litigation to enforce civil rights has been held by the Supreme Court to be a form of expression protected by the First and Fourteenth Amendments). Scholars have recently commented on the Supreme Court's ruling on the right to sue as a First Amendment right in the context of litigation funding. See Jones, supra note 40; see also Anthony O'Rourke, The Political Economy of Criminal Procedure Litigation, 44 GA. L. REV. (forthcoming 2011), available at http://ssrn.com/abstract_id=1573769 (offering a political economics analysis of the ability of a concentrated (and coordinated) impact litigation sector to affect the agenda and precedent of the U.S. Supreme Court in the area of criminal procedure). For another critical perspective on what are perhaps the true underlying rationales for contemporary restrictions such as maintenance and solicitation, consider Galanter's view that the "canons of ethics," and in particular prohibitions on solicitations and referral fees (of which fee-splitting arrangements are a type), disparately impact lawyers in the "lower echelons" of the profession who typically represent small clients. Galanter, supra note 6, at 116-17 & nn.50-51.

63. See Comment, supra note 62, at 1629 n.75.

easy to supervise litigation, one side of which is conducted by a party, while on the other side there are only nominal parties, the true controller of that side of the case being beyond the court's direct control.65

Today, while a minority of states have abandoned champerty restrictions, the majority of states retain and enforce the prohibition with varying degrees of zeal.66 Among the states still recognizing champerty restrictions, Minnesota represents those states which continue to rigorously apply them. In *Johnson v. Wright*, for instance, the Minnesota Court of Appeals reviewed the common-law history of champerty in the state and, in conjunction with its core ruling, stated that “an agreement in which [a party] had no interest otherwise, and when he is in no way related to the party he aids, is champertous and void as against public policy.”67 The court of appeals also squarely addressed the move towards modernization or elimination of champerty law by other states.68 Dismissing the respondent’s arguments regarding existing alternatives to champerty restrictions, the court of appeals wrote:

Although there are safeguards in place to alleviate the potential evils associated with champertous agreements, respondent fails to provide a compelling reason to completely abandon the doctrine. As an error correcting court, we do not presume to abandon the champerty doctrine simply because a few states have chosen to do so.69

Other states also continue to apply champerty restrictions with little apparent modernization. Delaware maintains that, under common law, an agreement is champertous whenever an assignee has no interest, either legal or equitable, in an assigned cause of action prior to the assignment.70 Further, “[i]t is the duty of the court to dismiss a case in which the evidence discloses that the assignment of the cause of action sued upon was tainted with champerty.”71

Conversely, New York represents those more progressive states which, while not abandoning the doctrine, have taken a cautious approach to its application. New York state law prohibits the purchase of debt, a thing in action, or any claim or

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68. See id. at 680.

69. Id.


71. Id.
demand, among other things, “with the intent and for the purpose of bringing an action or proceeding thereon.”72 Viewing champerty as, from its inception, a doctrine of more limited scope in the American legal system, New York courts have typically been hesitant to find that an action is champertous as a matter of law.73 The Court of Appeals of New York established a “primary purpose” test for determining whether conduct is champertous.74 As stated by the court of appeals in Bluebird Partners, L.P. v. First Fidelity Bank, N.A., the primary-purpose test is derived from a simple textual analysis of New York law and requires that an acquisition be made “for the purpose (as contrasted to a purpose) of bringing an action or proceeding.”75 In its application, the primary-purpose test does not require a third party to make an acquisition for the sole purpose of litigation, but appears to require litigation to be a major or motivating factor.76

As mentioned, a minority of states such as Massachusetts and South Carolina have abandoned champerty altogether. In Saladini v. Righellis, the Massachusetts Supreme Court declined to void an agreement despite explicitly stating that it was champertous.77 Addressing the application of champerty restrictions under common law, the court stated that, “We also are no longer persuaded that the champerty doctrine is needed to protect against the evils once feared: speculation in lawsuits, the bringing of frivolous lawsuits, or financial overreaching by a party of superior bargaining position. There are now other devices that more effectively accomplish these ends.”78 Similarly, in Osprey, Inc. v. Cabana Ltd. Partnership, the South Carolina Supreme Court abandoned champerty, stating that “We abolish champerty as a defense because we believe it no longer is required to prevent the evils traditionally associated with the doctrine as it developed in medieval times.”79

In sum, there appears to be a growing discontent with champerty restrictions in some quarters, but in most states champerty remains entrenched. A second regulatory barrier

72. N.Y. JUD. LAW § 489 (McKinney 2009).
74. See id. at 736.
75. Id.
76. See id.
78. Id. at 1226–27.
which has received virtually no attention in the context of litigation funding is the prohibition on fee sharing. That topic is taken up next.

B. THE PROHIBITION ON FEE SHARING WITH NONLAWYERS

A natural market solution to the lack of access to justice resulting from plaintiffs' inability to finance meritorious litigation could be for contingent fee lawyers and the Plaintiffs' Bar to go beyond attorneys' funding of litigation toward lawyers seeking outside investors to fund their clients' litigation. That would allow attorneys and firms to increase their capitalization and grow their firm, diversify, and spread the risk as does any business.

Lawyer compensation of nonlawyers for referrals or otherwise sharing fees with nonlawyers is, however, universally understood to run afoul of several ethical and professional standards and is widely prohibited.80 Rule 5.4 of the ABA Model Rules of Professional Responsibility states that "[a] lawyer or law firm shall not share legal fees with a nonlawyer."81 The rule has been widely adopted by states with only a few exceptions.82 Therefore, since the return on outside capital investment in any particular case (as opposed to investing in a law firm as a whole) would come from the recovery and fees collected by the attorneys, such capitalization is barred by the rules of professional responsibility.

As stated in the comments to Rule 5.4, this prohibition is intended to "protect the lawyer's professional independence of judgment."83 Regulators are also concerned by other client interests protected by the rules of ethics. Fee splitting is viewed as running the risk of granting nonlawyers control over the practice of law or potentially enabling lay persons to practice law without authorization.84 It is also feared that the prospect

84. Id.; see also Gassman v. State Bar, 553 P.2d 1147, 1551 (Cal. 1976) (noting that fee-splitting arrangements pose "serious danger to the best inter-
of receiving referral fees from lawyers would encourage non-layers to solicit prospective clients for practicing lawyers and thereby encourage the collusion of lawyers and laymen to violate attorney prohibitions on direct solicitation of clients.85

The prohibition on fee sharing is being avoided by the new institutional funders by contracting directly with the clients, not with their attorneys.86 The legality of this arrangement generally, and of particular clauses involved, such as those allowing a funder to “monitor” the progress of a litigation and to discontinue funding mid-litigation (i.e., arguably to control the litigation), have not yet been tested by the courts.87

As will be discussed in Part III, excluding the attorneys from having a direct relationship with the funders may not be the best way to ensure the clients’ very interests that the champerty doctrine and the prohibition on fee splitting seek to protect. Though it is important to note that while litigation funding and any claim transfer involved generally are prohibited, both are allowed in other contexts.

C. PERMISSIBLE LITIGATION FUNDING AND CLAIM TRANSFER

1. Contingency Fees

There are several instances where overriding policy considerations prevail over the restrictions and litigation funding and claim transfer are permitted. First and foremost is the contingency fee, a fee payable to the attorney only if the outcome of the representation is successful.88 Contingency fees usually take the form of a percentage of a recovery, but they do not

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86. This topic was discussed at the District of Columbia Bar seminar titled “Third-Party Funding in Arbitration” held on June 30, 2009. Funding firms also appear to be partly mitigating the effects of the rule of prohibition by being “offshore,” incorporating and listing overseas (though, operating in the United States as well). The uncertainty as to whether courts will uphold litigation funding if challenged arguably contributes to the speculative nature of the investment and therefore to its price (both the price to the client and the price of publicly traded shares of litigation-funding firms).

87. See supra note 55 and accompanying text (discussing the fact patterns and legal claims that have come before the courts).

necessarily have to be so. Since the contingency fee and its sibling, the class action, are key features of American civil litigation, the literature arguing for and against them is vast and wide.

One scholar has summarized the contentious debate surrounding contingency fees in the following manner:

Contingency fees are praised as the average person’s “key to the court-house” and attacked as the cause of excessive litigiousness, frivolous lawsuits, and greedy trial lawyers finding new ways to bring corporate America to its knees. Trial lawyers are blamed for contributing to, if not causing, the supposed “endless tide of litigation.” They encourage the “blame game,” whereby individuals do not take responsibility for their own lives but look to others for undue compensation and thereby increase insurance and other costs to everyone. These lawyers continue to enrich themselves through windfall fees in cases such as tobacco litigation. They engage in activities that contort the justice system to advance their own interests, contributing to excessive adversarialism. And they take advantage of naive injury victims, charging high fees to compensate for the risk they are undertaking when there is no doubt that the victim will recover damages.

Because the similarities between attorney funding and third-party funding are extensive, most of the discourse surrounding litigation funding is characterized by what some economists call an “attribute substitution”: a cognitive bias whereby individuals who need to make a complex judgment—here, regarding the desirability of the novel phenomenon of litigation finance—substitute that complex judgment for a more easily calculated heuristic. In our case, the easiest calculation is the desirability of contingency fees. In other words, commentators simply apply their preconceived views of contingency fees to litigation finance.

But third-party funding is different from attorney funding in several important ways. One key difference is that funders

89. See id.

90. See infra notes 91, 166 and accompanying text. While generally rejected or greatly restricted abroad, the practice of entering into these contingency fee arrangements is unquestionably permissible in the United States, with limited requirements on reasonableness and client disclosures. MODEL RULES OF PROF'L CONDUCT R. 5.4 (2003).

91. See IN LITIGATION: DO THE “HAVEs” STILL COME OUT AHEAD? 1–2 (Herbert M. Kritzer & Susan Silbey eds., 2003) (internal references omitted) (reviewing the literature for and against contingency fees and class action reform).

92. See Cass R. Sunstein, Moral Heuristics, 28 BEHAV. & BRAIN SCI. 531, 532–33 (2005) (arguing that attribute substitution is pervasive when people reason about moral, political, or legal matters, and given a difficult, novel problem in these areas, people search for a more familiar related problem and apply its solution to the harder problem).
are not providing a service for a fee but rather are investing in an asset. Another important difference is that litigation funding has the potential to benefit corporate America as much as it does the Plaintiffs' Bar and its clientele. Litigation funders are likely to develop ongoing relationships with both sides of this great divide.

An additional set of differences arises because law firms and finance firms are very different types of business entities. Consequently, litigation-finance firms are likely to have different investment goals, strategies, and competencies than law firms and are likely to generate different agency problems. Specifically, finance firms are not subject to the constraints imposed by the canons of professional responsibility. This means that they can take on matters that conflict, can solicit clients, and have nonlawyers in management positions. The latter speaks to another notable difference—governance structures. Funders, unlike law firms, have boards of directors. Funding firms do not have to limit themselves to the practice of law and may gain advantages through synergies with other financial products and services they offer. They can accept alternative forms of compensation, such as equity in intellectual property or exploration and drilling rights, and can join in the ventures of their clients. Last, but not least, there are differences in ownership structures and corporate finance options. Funding firms can—and do—raise investments from retail and institutional investors; they are likely to engage in secondary trading of the litigation stakes they purchase, and they may in the future engage in securitization of bundled legal claims.

These differences help explain the market gap left by the Plaintiffs' Bar that litigation-funding firms fill. Additionally, the importance of these differences, in particular the development of secondary markets in legal claims, will become apparent in the next Part as the discussion turns to the influence of


these unique characteristics on bargaining dynamics and, therefore, on the social function of litigation.

2. Insurance

A second major departure from champerty restrictions and the underlying concerns is insurance law. Insurance law allows for insurance contracts that include subrogation clauses through which the insured gives the insurer the right to sue for injuries covered by the policy. Moreover, as discussed in Part IV, insurance law is relevant not only as an example of departure from the prohibition on claim transfer but also because defense transfer is functionally equivalent to after-the-event insurance. Finally, insurance provides a pertinent analogy because there is a secondary market in securitized insurance contracts, which may mirror a possible market in legal-claims-backed securities.

Insurance is a cornerstone of modern economies:

When uncertainty is present in economic activity, insurance is commonly found. Indeed, Kenneth Arrow [the Nobel laureate] has identified a kind of market failure with the absence of markets to provide insurance against some uncertain events. Arrow stated that “the welfare case for insurance of all sorts is overwhelming. It follows that the government should undertake insurance where the market, for whatever reason, has failed to emerge.”

In order to overcome the agency problems—specifically, the moral hazard—inherent in the provision of insurance, insurers enter into complex contractual agreements with insureds.

95. See DEBORAH L. RHODE & DAVID LUBAN, LEGAL ETHICS 698 (3rd ed. 2001) (noting that with the protections granted by subrogation, insurers are essentially able to “stand in the shoes” of an insured and assert the insured’s rights against a third party, thus allowing them to recoup expenses paid to the insured).

96. See infra Part IV (explaining that insurance is the transfer of risk away from one party by distributing the risk among a sizable group of participants, and defining after-the-event insurance as insurance used to fund a lawsuit once litigation is already anticipated or has commenced).


98. Moral hazard, generally, is a type of agency problem in which one party, the agent, is responsible for the interests of another, the principal, but has an incentive to put its own interests first. Kevin Dowd, Moral Hazard and the Financial Crisis, 29 CATO J. 141, 142 (2009), available at http://www.cato.org/pubs/journal/cj29n1/cj29n1-12.pdf. The agent, who is insulated from risk, may behave differently from the way it would behave if it would be fully exposed to the risk. See id. In the insurance context, moral hazard refers to “the tendency of insurance protection to alter an individual’s motive to prevent loss. This affects expenses for the insurer and therefore, ultimately, the cost of
These agreements create complex relationships among insurer, insured, and third parties. They also create a host of associated rights and obligations, some of which are unique to the insurance context.\textsuperscript{99} At the heart of the liability insurance arrangement is an insurer's promise to defend an insured against covered claims.\textsuperscript{100} Reciprocally, the insurer—a third party—takes an interest in and control over the litigation.\textsuperscript{101} This takeover of the litigation is not only permissible but also in fact facilitated by the applicable law.\textsuperscript{102} This common scenario introduces a third party into the traditional attorney-client relationship. With the insurer directly paying the attorney for representing the insured, doors open to conflicts of interest between insurer and insured, and between insurer and attorney.\textsuperscript{103} This can lead to diminished client control or less independence in the attorney's judgment. In one possible scenario, an insurance company may wish to accept a settlement offer and avoid the risk of litigation, while an insured may seek to litigate as a perceived means of vindicating himself or defending his reputation.\textsuperscript{104}

\section{Other Permissible Claim Transfers}

Perhaps the most obvious, indeed paradigmatic, case of permissible claim transfers is the everyday practice of assigning contractual rights to third parties under general contract law. Unless prohibited by law or by provision of contract, parties are typically free to assign their contractual rights to others.\textsuperscript{105} Whether an assignment entails the mere transfer of the

\textsuperscript{99} See Shavell, \textit{ supra} note 98, at 541, 544 (discussing the different effects on parties to insurance agreements, which vary based on how the individual agreement is crafted).

\textsuperscript{100} See id. at 541 (characterizing “insurance protection” in terms of “expenses for the insurer”).

\textsuperscript{101} See \textsc{Tom Baker, Insurance Law and Policy: Cases, Materials, and Problems} 3-5 (2003) (explaining generally the insurance company's duty to “take care of insured losses”).

\textsuperscript{102} See id. at 25.

\textsuperscript{103} See id. at 4 (outlining some of the conflicts of interest that necessarily pervade the insurer-insuree relationship).

\textsuperscript{104} See \textsc{John F. Dobbyn, Insurance Law in a Nutshell} 916 (4th ed. 2003) (providing a thorough discussion of insurance defenses and conflicts of interest).

\textsuperscript{105} See \textsc{Arthur L. Corbin, Corbin on Contracts} § 47 (1964) (discussing the assignable nature of contracts); see also Sebok, \textit{ supra} note 7 (providing an
right to receive payment from a purchaser or the large-scale assignment of rights and obligations pursuant to a merger and acquisition deal, the practice is fundamental to contract law and is an aspect of the freedom of contract.

Another well-known example of sale and transfer of legal claims is debt collection. When a debtor fails to make payments on a debt his creditor may sell that debt to a third party, commonly known as a distressed-debt purchaser.\textsuperscript{106} Importantly, if the debt purchaser so chooses he may seek a \textit{judgment in court}.\textsuperscript{107} This is analogous to the interest in a judgment that a litigation funder obtains.\textsuperscript{108} Similar to the selling of claims as part of the debt collection process, by virtue of federal legislation, claims against bankrupt entities may also be sold to third parties as part of the court-supervised bankruptcy process.\textsuperscript{109} This practice is somewhat speculative and is generally engaged in by specialized institutional investors.\textsuperscript{110}

Somewhat less well-known are \textit{qui tam} actions that permit private parties—specifically, whistleblowers who report wrongdoing in government agencies—to bring suit on behalf of the government and to retain a portion of the award.\textsuperscript{111} Statutory in nature, \textit{qui tam} laws are typically viewed as state-mandated

\begin{footnotes}
\item[107] Id.
\item[111] See, e.g., Vt. Agency of Natural Res. v. United States ex rel. Stevens, 529 U.S. 765, 769 (2000) (involving the False Claims Act, which grants standing to "a private person . . . for the person and for the United States Government against the alleged false claimant, in the name of the Government" (internal quotation marks omitted)).
\end{footnotes}
mechanisms of private enforcement against public wrongs in the public interest. Like third-party funding, qui tam laws create a partial assignment of legal interests—the government's legal interests—to private parties. As such, they are particularly analogous to third-party funding of sovereigns in international arbitration.

Finally, life settlements (the sale of an existing life insurance policy to a third party) and the closely related viatical settlements (the purchase of a terminally ill person's life insurance) are practices that permit insureds to collect an amount greater than the surrender value of the policy but less than the face amount paid upon death. Purchasers of life settlements—commercial investors—are responsible for paying the premiums due on the insurance and in return are provided a new type of investment in which the return is heavily dependent upon how long the insured lives. As such, they give rise to a similar, or even heightened, knee-jerk reaction of distaste and disapproval as third-party funding of litigation. The proponents of the practice, however, cite the ability of the insured, often the very old or very sick, to cash in on their life insurance while still alive and use it to enhance their standard of care or standard of living.

At the outer edges, one can even imagine a form of litigation funding undertaken by nonprofits. Indeed, even the provision of pro bono services eliminates litigation costs. It therefore

112. See id. at 774–76 (discussing the history of qui tam actions in the United States and England).
113. See United States ex rel. Eisenstein v. City of New York, 129 S. Ct. 2230, 2236 (2009) (discussing qui tam actions under the False Claims Act); see also id. (providing an overview of qui tam legislation).
114. See Recent Innovations in Securitization: Hearing Before the Subcomm. on Capital Mkts., Ins., and Gov't Sponsored Enters. of the H. Comm. on Fin. Servs., 111th Cong. 51–62 (2009) (statement of Paula Dubberly, Associate Director, Division of Corporate Finance, U.S. Securities and Exchange Commission) [hereinafter Recent Innovations in Securitization Hearing] (providing background on life settlements and noting that life settlements have become so prevalent that there are now efforts to securitize them); see also Miriam R. Albert, Selling Death Short: The Regulatory and Policy Implications of Viatical Settlements, 61 ALB. L. REV. 1013, 1017–22 (1998) (relating the historical development of viatical settlements).
115. See Recent Innovations in Securitization Hearing, supra note 114, at 53.
116. See Albert, supra note 114, at 1015 (indicating that the perception of some is that viation is "ghoulish").
117. See id. (detailing the benefits offered by viatical settlements).
alters the power dynamics among attorneys, their clients, and opposing parties.\textsuperscript{118}

To conclude, examples abound of areas of law in which the benefits of claim transfers and litigation funding with the appropriate safeguards trump champerty concerns. In addition, foreign jurisdictions have found that the considerations underlying the champerty doctrine and similar barriers to litigation funding are either outdated or outweighed by the increased access to justice such funding can provide. They have thus moved from prohibition to regulation. The next Part first suggests another compelling reason to move from prohibition to regulation of litigation funding—its equalizing effects on litigants’ bargaining power and ability to affect rule change. Secondly, it provides a bargaining analysis that reveals agency problems that would need to be considered under a regime of regulation. Before doing so, the following section describes the structural limitation on one-shotters’ ability to play for rule change that the current prohibition contributes to.

\section*{D. Systemic Effects of the Prohibition on Litigation Finance}

As we have seen, prohibitions on agreements to acquire an interest in litigation were originally intended to stem corruption in the judicial process and maintain the integrity of the practice of law. Concerns regarding the integrity of the profession included fears that third parties could effectively control litigation, that attorneys or clients could share confidential information with the third party—raising both ethical and practical concerns—and that disagreement could arise among the parties and impose conflicting duties on attorneys. The prohibitions were also thought to limit frivolous lawsuits and to better align the interests of the attorney with those of the client.

While the prohibitions were meant to protect clients and the courts from being overrun by Great Men, they have, in fact, helped to achieve the opposite. The exclusion of have-nots from full use of the court system allows today’s Great Men—society’s haves—to overrun the courts. Virtually all of the literature arguing in favor of permitting litigation funding does so on the

\footnotesize{\textsuperscript{118} See Steinitz, supra note 21, at 213 (discussing pro bono services and the attorney-client relationship). For a discussion of how problems of control and agenda setting affect impact litigation (i.e., litigation by nonprofit organizations), see generally Ann Southworth, Business Planning for the Destitute? Lawyers as Facilitators in Civil Rights and Poverty Practice, 1996 WIS. L. REV. 1121.}
basis that it will reverse the exclusion of have-nots from the courthouse.\textsuperscript{119} This Article will focus on an overlooked aspect of litigation finance: its potential to significantly reduce the Great Men's grip on the courts.

That such a grip exists can be seen most clearly in Marc Galanter's classical account of why society's haves come out ahead in litigation.\textsuperscript{120} Galanter famously argued that "the basic architecture of the legal system creates and limits the possibilities of using the system as a means of redistributive (that is, systematically equalizing) change."\textsuperscript{121} In so doing, Galanter created a typology of litigants and showed how the outcome of litigation is affected by the type of litigants involved. He identified two types. The first are one-shotters—claimants who have only occasional recourse to the courts.\textsuperscript{122} These are usually smaller players and the stakes represented by the outcomes of their cases may be high relative to their total worth.\textsuperscript{123} Their cases are either too large (relative to the one-shooter's size) or too small (relative to the cost of litigation) to be managed routinely and rationally.\textsuperscript{124} The second type are the repeat players who are engaged in many similar litigations over time, have had and anticipate repeated litigation, have low stakes in the outcome of any one case, and have the resources to pursue their long-term interests.\textsuperscript{125} The repeat player has the following structural advantages over the one-shooter:

[Repeat players] have advance intelligence; they are able to structure the next transaction and build a record... [Repeat players] develop expertise and have ready access to specialists. They enjoy economies of scale and have low start-up costs for any case... [Repeat players] have opportunities to develop facilitative informal relations with institutional incumbents... [The repeat player's] interest is in his "bargaining reputation"... [Repeat players] can play the odds. The larger the matter at issue looms for [the one-shooter], the more likely he is to adopt a minimax strategy (minimize the probability of maximum loss). Assuming that the stakes are relatively smaller for [repeat players], they can adopt strategies calculated to maximize gain over a long series of cases, even where this involves the risk of maximum loss in some cases. Repeat players can play for rules as well as immediate gains... [A repeat player] may be willing to trade off tangible gain in any one case for rule gain... We would then expect

\begin{thebibliography}{9}
\bibitem{supra} See supra Part III.
\bibitem{Galanter} Galanter, \textit{supra} note 6, at 125 fig.3.
\bibitem{Id} \textit{Id}. at 95.
\bibitem{Id2} \textit{Id}.
\bibitem{Id3} \textit{Id}. at 98.
\bibitem{See id} \textit{See id}.
\bibitem{Id4} \textit{Id}. at 97.
\end{thebibliography}
repeat players to "settle" cases where they expected unfavorable rule outcomes. . . [One-shotters] should be willing to trade off the possibility of making "good law" for tangible gain.126

Given these structural advantages, argues Galanter, neither litigation nor rule change proves effective from a redistributive perspective since one-shotters do not get to create rule change through litigation.127 This diminished ability to fully participate in society comes in addition to the familiar problem of lack of funding and so-called litigation fatigue—depleted monetary and emotional resources needed to pursue lengthy litigation—which leads one-shotters to settle meritorious cases at a discount or to refrain from bringing them altogether.128 Only change at the level of parties is likely to generate change at other levels including, importantly, the level of rule-change.129

In short, repeat players both understand the system and have the long-term perspective that allows them to game the system. One-shotters, on the other hand, may not have enough experience with the system to understand it. Even when they do, they may not have the desire or the flexibility to risk a short-term loss in favor of a long-term gain that will likely accrue to someone else.130 In addition, one-shotters are likely to overweight the potential for extreme, but unlikely events (like a catastrophic judgment), while underweighing the prospect of average events.131 Lowering the potential for loss, via a risk-transfer mechanism, allows funded parties to pursue a more aggressive and more rational bargaining stance and to avoid unnecessary discounts.132

126. Id. at 98–103 (emphasis added).
127. Id. at 95.
128. See Marc Galanter & Mia Cahill, "Most Cases Settle": Judicial Promotion and Regulation of Settlements, 46 STAN. L. REV. 1339, 1349 (1994); Mnookin & Kornhauser, supra note 8, at 971–72.
129. See Galanter, supra note 6, at 150. Apparently, this is also true thirty-five years later. See Karyl A. Kinsey & Loretta J. Stalans, Which "Haves" Come Out Ahead and Why?, in IN LITIGATION, supra note 91, at 138.
130. See Galanter, supra note 6, at 98–101.
132. See Galanter, supra note 6, at 98–101 (relating lack of high risk to a higher potential for deliberately planned strategies).
III. LITIGATION FINANCING CHANGING THE GAME:
WHEN LITIGATION CEASES TO BE EXPENSIVE AND
UNCERTAIN

A. A NOTE ON TAXONOMY

The current discourse on litigation funding in its entirety debates the merits and demerits of litigation funding en masse, as if there is one type of funding in question. But to understand how litigation funding may alter the systemic inequities described above, one must employ a nuanced analysis that treats litigation not monolithically, but as a combination of the type of claim, the type of funder, and the type of client. These three factors can be further broken down in the following manner. First, the type of claim funded varies as a defense or a plaintiff’s claim, by the area of law, and by the kind of process (litigation or arbitration, domestic or international). Second, the types of funders possible are commercial funders (institutional or individual), political funders (e.g., donor governments in international arbitration), and public funders (e.g., non-governmental organizations). Finally, the type of client in question can be an individual plaintiff, a class (represented by counsel), a corporation, or a sovereign. Any analysis of litigation funding must first classify the type of litigation in question based on these three factors.

Particularly significant is the classification of litigation funding into two overarching categories—defense funding and claim funding. Indeed, one of third-party funding’s distinctive features is that, unlike changes at the level of parties like class action arrangements, litigation funding can be used by both plaintiffs and defendants to improve their ability to bargain. Among other things, this makes it more politically viable than class action reform or other contemplated reforms. But litigation funding functions very differently on each side of the divide. Claim funding functions as a form of finance whereas defense funding functions as a form of insurance.

For example, readers’ intuition regarding the desirability of the litigation funding described in the examples in the opening of the article probably depends on the funder in question: China’s Sovereign Wealth fund, an oil company, a wealthy and politically motivated individual, or an investment company. It

133. This is probably due to the conflation of litigation finance and contingency fees. See supra text accompanying note 92.

134. This Article focuses only on the first category—commercial funders.
similarly may depend on the funded party: the government of a
developing country, a large corporation, or indigent villagers in
Angola. Additionally, intuitions are probably influenced by the
subject matter of the litigation: proprietary information regard-
ing sensitive American military technologies, national bounda-
ries, a securities class action, sexual harassment, or environ-
mental and human rights abuses.

B. PARTIES' ABILITY TO "PLAY FOR RULES"

The rest of this Part shows how litigation funding can a-
meliorate the systemic inequalities described above—achieving
Galanter's change at the level of the parties—by analyzing its
effects on bargaining dynamics and ability to play for rule
change for different combination of claims and clients. Relating
the taxonomy above to Galanter's categories from Part III,
many consider individuals serving as plaintiffs to be paradigm-
atic one-shotters and corporations to be paradigmatic repeat
players. In addition, this Article will introduce the notions of
modified one-shotters and modified repeat players. These con-
cepts will be elaborated upon in detail in the following pages. In
summary, modified one-shotters are parties that have low play
repetition but nonetheless enjoy some of the benefits that
usually come with repeat play. Modified repeat players are
players who, while playing the litigation game repeatedly,
nonetheless do not reap the full benefits that repeat play may
afford.

These two concepts are important to the analysis because
at the heart of the following argument is the idea that litigation
funding has the potential to transform both one-shotters (have-
nots) and repeat players (haves) into modified repeat players
and to level the playing field. In a nutshell, by compounding
the bargaining power of one-shotters and modified one-shotters
(such as individuals and sovereigns) while decreasing the bar-
gaining power of repeat players (such as corporations) both of
whom must cede some power to the funders, litigation funding
would, in essence, transform all types of parties into different
types of modified repeat players. This potentially increases one-
shotters' and modified one-shotters' ability to play for rules
more than substantive legislative reform would. However, the
potential equalizing effect of litigation funding is hampered
by two factors: (1) the emergence of secondary markets in legal
claims, and (2) the fragmentation of the triangular attorney-
client-funder relationships. Both of these factors introduce
agency problems that undercut the full equalizing potential of litigation funding. These concepts are illustrated by the following figure, which shows the parties to a funded litigation in the context of the (potentially) limiting factors noted above.

The following sections describe the transformation of one-shotters, modified one-shotters, and repeat players into different forms of modified repeat players as well as the potential leveling effect and attendant agency problems.

1. Individual, Class, and Sovereign Plaintiffs as Modified Repeat Players

Litigation financiers seek investment in the claims or defenses of four types of parties. First, they seek to invest in claims and defenses of corporations, which are the paradigmatic repeat players. Second, they seek to invest in claims of individual plaintiffs, who are the paradigmatic one-shotters. Third, they seek to invest in the claims of classes. Classes are comprised of aggregate one-shotters who, via the aggregation and funding process, become modified one-shotters. As discussed below, the class’s distinctive features, including the alignment with a repeat-player firm, gives these individuals some, but not all, of the bargaining advantages of repeat play. Finally, litigation funders may invest in claims of sovereigns in international arbitration. Sovereigns, whose distinctive features are discussed below, can also be thought of as modified one-shotters as they enjoy some extra-legal leverage afforded them by their special role and heft. The following paragraphs expound on the
effects that third-party funders may have on the ability of these four types of litigants to play for rules given each type's unique characteristics. Where applicable, the effects of the area of law in question and of the process are also discussed.

One-shotters' (i.e., individual plaintiffs') bargaining positions will be most radically transformed by litigation funding as plaintiffs are transformed from one-shotters to modified repeat players. By allying themselves with repeat-player funders, these plaintiffs will now reap the benefits of economies of scale, accumulated expertise, and a limited ability to play for rules, in addition to gaining access to justice. They will no longer have to focus on minimizing the risk of maximal loss (rather than maximizing the chance of gains). To the extent that a funder has informal ties with institutional incumbents, the individual defendants will now be able to reap the benefits. And, the individual plaintiff will now have the resources to engage in signaling to its opponents, including by transmitting promises, threats, and bluffs, all of which enhance her bargaining position. In fact, an institutional commercial funder's willingness to fund a lawsuit, if known to the opposing party, may itself function as a signal to the opposing party regarding the strength of the claim. Such a signal can strengthen the funded party's bargaining position and enhance the chances of an early and high settlement. This, in turn, may create positive externalities as cases get settled and taken off courts' dockets early.

Classes, already modified one-shotters by virtue of their alliance with plaintiffs' firms, will continue reaping the rewards of increased access to justice, economies of scale, advanced intelligence, and expertise. They also will continue trading

135. Individuals, sovereigns from the developing world, and some classes—especially in very complex and therefore very expensive cases that the Plaintiffs' Bar cannot absorb—will gain the largest increase in access to justice. For a discussion of the ability to fund very large and complex cases being capped, see Marc Galanter, Anyone Can Fall Down a Manhole: Contingency and Its Discontents, 47 DePaul L. Rev. 457, 468 (1998).

136. See Galanter, supra note 6, at 98–99 (explaining the potential benefits of association with institutional incumbents).

137. Mnookin & Kornhauser, supra note 8, at 972–73.

138. Id. (explaining the forms of transmission of information in litigation and negotiation). See generally Camerer, supra note 8 (outlining facets of strategic interaction between parties in various circumstances).

139. See Galanter, supra note 6, at 98–99 (describing the advantages in intelligence, specialization, and expertise that repeat players have over individual plaintiffs).
those off for diminished control and sharing the interest in rule change with that of a funder (now an investment firm rather than, or in addition to, a plaintiff's firm). 140 The two biggest changes third-party funding—as opposed to attorney funding—introduces into the class action context are the effects of secondary markets in legal claims, 141 and that classes may now find themselves up against funded defendants (i.e., defendants that have transferred the risk of litigation but also some of their control over settlement and their ability to play for rules). 142

Courts and regulators also should consider a conceptual difference between attorney funding and third-party funding. While third-party funders may reap outsized rewards on their investments—up to fifty percent of very large judgments—these cannot be viewed, from a moral standpoint, as windfall fees as they are viewed in the attorney-funding context. Attorneys provide legal services for their fees whereas investors invest. The intuition underlying the lodestar standard, according to which a law firm’s return should be a function of the time spent on the case, 143 does not have an equivalent in the pure investment realm where returns on an investment are not capped per se.

Sovereigns, like individuals, have low rates of play repetition. 144 They are therefore less likely to play for rules. 145 How-

140. The Australian experience shows that investment firms do not necessarily compete with the Plaintiffs’ Bar. Rather, investors tend to fund litigation through established plaintiffs’ firms. This causes a repeat play amongst funders and attorneys that then further complicates the client’s bargaining position within the triangular relationship. Interview with Anonymous, Exec., Undisclosed Inv. Firm (Nov. 2009).
141. See infra Part III.C.1.
142. See infra Part III.B.2.
143. Lindy Bros. Builders, Inc. v. American Radiator & Standard Sanitary Corp. established the lodestar standard courts use to assess the reasonability of attorneys' fees in class actions and bankruptcy cases. 487 F.2d 161, 166–69 (3d Cir. 1973), vacated, 540 F.2d 102 (3d Cir. 1976). It consists of multiplying counsel’s reasonable hours by a reasonable hourly rate, which is then adjusted by several factors. Id.
144. The outlier example is Argentina, which has been a party to far more arbitrations than any other state, acting as the respondent in forty-six investment arbitrations in the wake of its economic financial crisis in the early 2000s. See Lisa E. Sachs & Karl P. Sauvant, BITs, DTTs, and FDI Flows: An Overview, in THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT, at xxxviii–xxxix (Karl P. Sauvant & Lisa E. Sachs eds., 2009). More representative are the following examples in the international investment arbitration context: Mexico is a far second to Argentina, having been a respondent in eleven cases, and all but six other countries have been party to three or fewer dis-
ever, like repeat players, they may exhibit strategic behavior—like settlement avoidance even with “bad” fact patterns and vice versa—due to considerations other than a pure cost/benefit analysis of a single arbitration. \(^{146}\) Therefore, sovereigns can be considered modified repeat players. With the exception of the most developed nations sovereigns do not have in-house expertise in international arbitration and, therefore, they may or may not be sophisticated players. \(^{147}\) In many cases, a single arbitration is likely to be very high-stakes (i.e., too large to manage routinely and rationally). \(^{148}\) But sovereigns are not similar to individuals in all ways. They may have and use extra-legal negotiating leverage—such as the power to expropriate, regulate, withdraw from the treaty regime underlying the arbitration body, use diplomacy, or resort to arms. \(^{149}\) Sovereigns are

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\(^{145}\) See supra notes 126–29 and accompanying text (discussing rule change as it relates to one-shotters and repeat players).

\(^{146}\) See id.

\(^{147}\) In reality, first-world sovereigns and third-world sovereigns deserve separate treatment. First-world sovereigns are often more sophisticated, have more access and capacity to use in-house and outside expertise, are more likely to play for rules and, critically, can structure transactions in advance based on their knowledge of the arbitration game. However, for the sake of simplicity, I group both types of sovereigns together for the purposes of the analysis herein and leave the task of further discussion of the disparate impact of arbitration financing on these two types of sovereigns and of litigation funding of international arbitration and adjudication to a separate article.

\(^{148}\) There are many examples of the very high stakes in international arbitration and adjudication. See, e.g., Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory, Advisory Opinion, 2004 I.C.J. 136, 137–39 (July 9) (addressing the legality of the security wall constructed by Israel in the Occupied Palestinian Territory); Gov't of Sudan v. Sudan People's Liberation Movement/Army (Abyei Arbitration), Final Award, ¶¶ 28–45 (Perm. Ct. Arb. 2009), available at http://www.pca-cpa.org/upload/files/Abyei Final Award.pdf (arbitrating a boundary-straddling territory rich in natural resources that was funded by donor governments' donations via the Financial Assistance Fund of the Permanent Court of Arbitration); Appellate Body Report, United States–Subsidies on Upland Cotton, ¶¶ 1–9, WT/DS267/AB/R (Mar. 3, 2005) (arbitrating the United States' practice of subsidizing cotton farmers in the context of a highly politicized challenge by Brazil which may influence an entire section of the domestic economy).

\(^{149}\) For example, discontented with the outcome of investment arbitrations it was involved in, Bolivia withdrew from the ICSID regime. Press Release, Int'l Centre for Settlement of Inv. Disputes, Bolivia Submits a Notice Under Article 71 of the ICSID Convention (May 16, 2007), available at http://icsid.worldbank.org/ICSID/StaticFiles/Announcement3.html. Bolivia also attempted
relatively likely to have the advantage of the possessor of the good in question. And, like other repeat players, they may have domestic and international public opinion considerations since they are accountable to their constituencies and susceptible to international pressures.

As in the cases of individual plaintiffs and very large class actions, sovereigns in the developing world stand to gain very significant increases in access to justice through litigation funding. Currently, most financing of sovereign claims or defenses is in the context of international commercial and investment arbitration. Sovereigns may choose to use such funding to enforce their rights under cross-border contracts to which they are a party.150 Other than the lack of funds or an inability to justify to their impoverished constituencies spending high-end Western rates on lawyers from the developing world, the greatest challenge facing governments in the developing world is a lack of capacity.151 This is both a lack of capacity among local lawyers to carry on the kind of specialized litigation that takes place in international arbitrations, and a lack of capacity to reach out to, vet, and retain Western lawyers who possess such specialized skills.152 Litigation funding, especially by funds spe-


150. For example, some governments in the developing world may have claims against pharmaceutical companies for IP rights in, and royalties from, commercial medicines developed from research in that country, extractive industries for rents and royalties, and for breach of infrastructure development contracts. Interview with Anonymous, Legal Advisor, Gov'ts in the Developing World (Feb. 2010). Here, in particular, the entrepreneurial model, wherein funders seek out potential cases, may provide a useful tool to governments in the developing world that may not have the capacity to identify and pursue their claims. Id.

151. See Steinitz, supra note 21, at 237 n.113 ("[O]ften there is a vast capacity gap between the attorneys and their clients.").

152. See id. at 210–22, 224–26 (discussing the capacity challenges, the relationship between Western lawyers and developing sovereigns, and the professional responsibility deficit in cross-border litigation). See generally YVES DEZALAY & BRYANT G. GARTH, DEALING IN VIRTUE (1996) (discussing the hy-
cializing in international arbitrations, may be able to bridge these gaps. Similarly, international arbitration is characterized by the very small number of private institutions that administer the vast majority of arbitrations. Funders are therefore likely to create informal ties with these institutions from which their clients may benefit. Given the highly centralized and exclusive nature of the International Arbitration Bar, agency problems between the client, on the one hand, and the funders and attorney, on the other, may pose particular challenges as the funder-attorney relationships are likely to often become a repeat-play relationship.

In addition, a particular challenge posed by this type of litigant is that sovereigns, at least according to liberal-democratic conceptions of government, represent their citizenry. One implication is that the subject matters of the disputes they are involved in may be ones in which the public interest is heightened. For example, they may involve: natural resources, future generation funds, national boundaries, the legality of domestic trade, investment, environmental policies and regulations; and national security. These are also subject matters in which a single case, such as one on the legality of domestic regulation of foreign investments under international investment treaties, may affect rule change. Whether the sovereign in question is litigating a pure commercial dispute or a public law dispute, transparency is an issue; both international commercial arbitration and public international law arbitration are notorious for their lack of transparency. In comparison, sovereigns involved in cross-border (or domestic) litigation, as opposed to international arbitration, may present somewhat less

per-specialization in international arbitration; the monopoly of Western, especially Anglo-American, lawyers over the practice; and the highly exclusive nature of the international arbitration bar.


154. See supra note 148.

155. All commercial international arbitration is, by definition, confidential. See, e.g., INT’L CHAMBER OF COMMERCE, ICC RULES OF ARBITRATION, app. II, art. I, available at http://www.iccwbo.org/court/arbitration/id4093/index.html (indicating that sessions and documents relating to cases are confidential). Investment arbitrations are slightly more transparent. See INT’L CENTRE FOR SETTLEMENT OF INV. DISPUTES, CONVENTION ON THE SETTLEMENT OF INVESTMENT DISPUTES BETWEEN STATES AND NATIONALS OF OTHER STATES, art. 48, cl. 5 (“The Centre shall not publish the award without the consent of the parties.”).
of a public policy challenge since proceedings are public. In sum, investing in public international arbitrations, commercial international arbitrations, and cross-border litigation may each call for different analyses by arbitrators and judges requested to rule on disputes emanating from funding arrangements, as well as by regulators and the parties themselves. All three differ from domestic litigation as discussed above.

As the foregoing paragraphs demonstrate, the potential for increased one-shotters and modified one-shotters influence on rule change offered by litigation finance is manifold. First, litigation finance can afford one-shotters and modified one-shotters the ability to overcome litigation fatigue—among other benefits of repeat play—which are necessary (though not sufficient) conditions to play for rules. In situations where a single case can change rules for the modified one-shotter (e.g., some international arbitrations), the newfound ability to play for rule change due to the mere introduction of litigation finance is obvious.

More generally, however, litigation offers many instances where rule change is achieved even if settlement occurs because rule change can occur during pretrial proceedings such as motions to dismiss, motions for summary judgment, and appeals from interim decisions. Such pretrial stages can be expensive to pursue. A one-shotter may therefore either settle prior to exhausting such steps or proceed to trial without the strategic advantages that pursuing them may provide. Thus, even a tendency to settle does not necessarily preclude rule change.

2. Corporate Defendants as Modified Repeat Players

One must consider how defendants’—in addition to plaintiffs’—positions, in particular ability to play for rules, may change. Corporate defense is the only form of defense-side funding currently contemplated by the litigation-funding indus-

156. Phoenix Action, Ltd. v. Czech Republic raised a similar issue to the claim transfer in a funded international arbitration. ICSID Case No. ARB/06/5, Award (Apr. 15, 2009). In Phoenix, the arbitrators were called on to decide the significance of the fact that the ownership over all the assets of a company was transferred to another. Id. ¶¶ 143–44. This shell company was formed in another country for the sole purpose of enabling the new entity to have standing to initiate a claim on behalf of the original company, and to do so under the ICSID Convention and ICSID jurisdiction. Id. The arbitrators ruled that the attempt was an abuse of process. Id.
Defense funding is the functional equivalent of after-the-event insurance since it takes the form of allowing a company to pay the expected value of a lawsuit plus a premium to protect it against a higher-than-expected loss. Litigation finance therefore addresses a market failure: "Insurance companies do not sell after-the-event insurance policies for lawsuits that already have been filed and there isn't a market in which litigants can trade away litigation risk." Such "insurance" allows companies to (1) hedge against the loss involved in an unfavorable award; (2) minimize and, just as importantly, predict litigation costs; and therefore (3) eliminate the effects that having uncertain litigation on the company's books has on its ability to engage in major transactions.

From a bargaining perspective, such "after-the-event insurance" can transform corporate defendants, the paradigmatic repeat players, into modified repeat players as they transfer the defense of their litigations to funders. While still enjoying economies of scale, advanced intelligence, the ability to structure the next transaction, and access to specialists, these corporations have diminished control over litigation and settlement. Their abilities to strategically transmit information, to control their bargaining reputation, to maximize gain over long series of cases and, importantly, to play for rule change are diminished as some of that control is ceded to funders whose interests may diverge from that of the corporate defendant. In other words, the social function of litigation changes structurally via litigation funding not only by increasing one-shotter plaintiffs' ability to affect rule change via the courts but also by corporate defendants' diminished ability to do so.

157. See Molot, supra note 7, at 376-77 (stating that "[o]utside this context... transaction costs and adverse-selection problems are likely to loom too large" for defense-side risk transfer).

158. Id. at 367. Because the event has already occurred, the primary cost—the underlying harm—is not transferred. It is the cost of litigation that is transferred, as well as the risk of a larger-than-expected award. See id. at 371 (illustrating the broad range of costs a party could potentially face).

159. See id. at 374–75 ("[T]he uncertainty surrounding a significant potential liability may increase a company's cost of capital by depressing its stock price or increasing the interest rate it must pay on its debt. Where litigation risk interferes with an equity investment, a debt refinancing, or a merger or acquisition, the tertiary costs of litigation can dwarf the primary costs. In those instances, a system of risk pooling would do more to reduce the costs of litigation than radical procedural reform ever could hope to achieve." (emphasis added)).

160. Though there is no symmetry here, a corporation still has the wherewithal to retain the litigation as it always has if it chooses to retain the ability to play for rules. For one-shotters, on the other hand, third-party finance—
However, corporate-defense transfer and its effects on corporate bargaining power have social drawbacks. Perhaps the most significant social drawback is the moral hazard created in the form of diminished deterrence and lessened incentives to avoid harmful activities and prevent harm. In addition, depending on how the risk transfer is structured and how much of it the corporate defendant retains, the corporate defendant would have less of an incentive to participate in a vigorous defense of its case. This moral hazard would be transferred onto the funder's own investors if and when legal claims and defenses are securitized. Lastly, any redistributive advantages that may be achieved by transferring funds from corporate defendants to other social actors via punitively high jury awards is eliminated when corporate defendants can transfer litigation risk. Thus, litigation financing affords quasi-immunity to corporations as the threat of large-scale litigation is thereby diminished. One implication is that legislatures and judges may wish to treat corporate-defense transfer differently depending on the areas of law (e.g., by allowing transfers for business disputes but not for environmental or human rights disputes) in order to avoid such quasi-immunity.

3. Funders' Incentives to Play for Rules

As discussed, an unexamined question is the effect third-party funding may have on categories of litigants' ability to play for rules. While rule change is a public good, it may be profitable for litigation funders to invest in rule change. This is because they manage a portfolio of litigation and, in particular, because they invest repeatedly and sequentially in certain categories of cases (e.g., international arbitration or intellectual property). This may initially seem counterintuitive because of the similarities between third-party funding and attorney funding—particularly, in terms of agency problems. Many of

with its diminished control—may be the only option for seeking any form of redress. See supra note 128 and accompanying text. However, the value of any given defense for rule change may only come to light after control over it has been transferred to the funder, because the potential for rule change has become apparent from facts revealed in the discovery process or because the law has changed post-transfer.

161. See Molot, supra note 7, at 376–77.


163. See supra note 94.
the agency problems that one might expect to emerge with the introduction of third-party funding have been discussed extensively in the context of the attorney-client relationship in contingency cases. Chief among the oft-cited concerns in the contingency context are conflicts of interest between attorneys and clients. The argument is that attorneys (and funders) have an incentive to settle early for a relatively low, but certain, recovery rather than incur the costs of going to trial and risking no or lesser recovery. In addition, attorneys (and funders) have an incentive to underinvest in a given representation as there are diminishing returns in additional time investment beyond a certain point. Both problems are exacerbated by the fact that contingency lawyers (and funders) make decisions across a portfolio of cases—trading off a small gain in one case for a larger gain in another case achieved with the same time-investment and reputational costs. When the contingency fee is applied in the class action context, perhaps the most important context in which it operates and a key area of potential investment for litigation-finance firms, additional problems arise. These include increased agency costs—including bonding, monitoring, and residual costs—which permit opportunistic behavior by attorneys, asymmetric stakes due to the fact that defendants’ lawyers stand to lose more than do plaintiffs’ lawyers, and cost differentials which tend to encourage strike suits.

164. See, e.g., Jonathan R. Macey & Geoffrey P. Miller, Judicial Review of Class Action Settlements, 1 J. LEGAL ANALYSIS 167, 193 (2009) (remarking that the interests of the client and attorney are unlikely to be aligned in these cases).


166. Arguably, early settlement, which is likely to be the outcome in the majority of funded cases, creates a positive externality. "From the social ... perspective the savings from settlement are larger than the sum of the parties' cost savings because society also avoids incurring the court's expenses." Shavell, The Fundamental Divergence, supra note 8, at 602. Similarly, contingency fees not only create an incentive for the lawyer to underinvest but also for the client to demand overinvestment (i.e., to demand measures the client would not have been willing to pay for had the cost of litigation not been shifted). See Hay, supra note 165, at 508–11 (discussing the incentive to underinvest). For other agency problems in the contingent-fee context, see generally id., and Macey & Miller, supra note 164 (discussing agency problems in settlement negotiations). Contingent fee legal practice is sometimes likened to portfolio management. See KRITZER, supra note 88, at 10–11. Modern portfolio theory argues that investors should balance and maximize an expected return and uncertainty of a combination of investments (i.e., mitigate avoidable risks though portfolio diversification). See generally HARRY MARKOWITZ, PORTFOLIO SELECTION: EFFICIENT DIVERSIFICATION OF INVESTMENTS (1959).

167. See John C. Coffee, Jr., The Regulation of Entrepreneurial Litigation:
But the portfolio heuristic can shed new light on the common critique regarding the incentive to settle early. As managers of a portfolio, contingency-fee lawyers and funders can afford to take on the risk of losing a given case while the individual plaintiff can hold out for a better settlement or an adjudicated outcome.\textsuperscript{168} Whereas the client might be reluctant to proceed if required to bear all the costs of uncertainty, the lawyer is less concerned about the loss in any individual case and more concerned about outcomes across a portfolio of cases.\textsuperscript{169} This insight is important to the argument that litigation financiers may value precedent, and therefore play for rules, in a few important cases.

A more general application of the portfolio heuristic to attorneys’ contingency practice, and by extension to funders, reveals that going to trial rather than settling (and settling late rather than early) may be strategic for the portfolio owner and manager for a number of reasons. First, going to trial generally may be advantageous, especially for new funders, in order to develop skills (such as highly specialized investment arbitration skills) and subject-matter expertise. These skills and expertise will allow such funders to be more efficient in the future in their case selection, pretrial strategy, and settlement negotiations.\textsuperscript{170}

\textit{Balancing Fairness and Efficiency in the Large Class Action}, 54 U. CHI. L. REV. 877, 882–83 (1987) (defining agency costs as “the costs of monitoring the agent,” in this case, the lawyer; bonding costs as “the costs the agent incurs to advertise or guarantee [the principal’s] fidelity”; and residual costs as “the cost of opportunistic behavior that is not cost-efficient to prevent”).

\textsuperscript{168} KRITZER, supra note 88, at 16.

\textsuperscript{169} Id. at 15. Kritzer notes, based on surveys and interviews, that contingency lawyers are rarely conscious of the applicability of portfolio theory to their practice management. Id. at 12–13. However, even a cursory study of professional litigation-finance firms’ disclosures shows that they do, indeed, consciously manage their litigations as a portfolio in the strict sense of the word. See, e.g., Press Release, Burford Capital, supra note 19 (“Burford believes that investing in commercial disputes must be conducted, and evaluated, on a portfolio basis instead of focusing on the performance or results of individual cases.”). The application of portfolio management principles to litigation financiers’ case management strategies therefore applies to them \textit{a fortiori}.

\textsuperscript{170} See Marc Galanter, \textit{Case Congregations and Their Careers}, 24 LAW & SOC’Y REV. 371, 372 (1990) (discussing “case congregations”—sets of substantively related cases that create incentives for attorneys to invest heavily in early cases to facilitate later cases because cases may be substantively similar, and because lawyers can use what they learn in handling earlier cases to their advantage in later cases); see also KRITZER, supra note 88, at 13–14 (“The [key to a portfolio perspective is] the need to understand the relationship among cases in the portfolio; in portfolio theory this is the issue of ‘correlation.’")
Second, going to trial generally may be advantageous, especially for new funders, in order to develop a reputation for a willingness to go to trial and for an ability to win trials.\textsuperscript{171} This reputation will allow them both to be competitive in attracting clients (reduce bonding costs) and effective in eliciting early and high settlements in later cases.\textsuperscript{172} In such cases, where funders (lawyers or financiers) go to trial for reasons other than rule change, any incidental rule change may be a by-product—an externality—of the process through which funders train themselves, position themselves, and market themselves.

But, thirdly, going to trial specifically in order to obtain rule change may be strategic for litigation funders (lawyers or financiers) because the value of precedent is greater for them than it is for their one-shotter clients. Economists have argued that

\begin{quote}
when neither party is interested in precedent, there is no incentive to litigate, and hence no pressure on the law to change. When only one party is interested in precedent, that party will litigate until a favorable decision is obtained; the law in such cases will favor parties with such an ongoing interest.\textsuperscript{173}
\end{quote}

Moreover, the law will come to favor the more concentrated and coordinated parties with such an ongoing interest in the law. Plaintiffs’ attorneys, in particular, are such a group. For example, “the major group with an interest in changing tort law is tort lawyers.”\textsuperscript{174} Tort law has therefore been influenced by the...

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... [One] way cases may be related is reputationally. That is, [a funder] may rely upon a reputation developed in one case to create expectations on the part of the defendant. The reputation may concern any of a variety of things. The [funder] may be known as someone who is a hard bargainer. The [funder] may be known for thoroughly preparing cases. The [funder] may be regarded as someone who is very selective in the cases accepted for representation. ... Reputation is important for a second reason as well. ... [A funder’s] reputation is central for attracting clients, either directly or through referrals. Thus, a [funder] may choose to do something in a particular case, such as go to trial, if the [funder] believes such an action will enhance his or her reputation in a way that will attract future clients. Alternatively, a [funder] might accept work that is not highly remunerative, but that attracts substantial publicity ... for the reputational gains ....

\textsuperscript{171} See supra note 170 and accompanying text.

\textsuperscript{172} See supra note 170 and accompanying text.

\textsuperscript{173} Rubin, Why Is the Common Law Efficient?, supra note 8, at 61 (emphasis added).

\textsuperscript{174} Rubin & Bailey, The Role of Lawyers, supra note 8, at 808 ("[W]e have discussed only tort law. However, as we indicate below, the same types of changes that occurred in tort law were also occurring in other branches of law."). Rubin and Bailey’s empirical data is both statistical and anecdotal. \textit{Id.} at 817–21. For example, they report that:
ability of plaintiffs' attorneys to organize and "by the interest of lawyers in the future value of precedents."\textsuperscript{175} For this reason, it will sometimes be in the interests of plaintiffs and their attorneys to litigate rather than settle a case in order to obtain a change in precedent. For example, tort lawyers internalize much of the value of a rule of strict liability. Other examples of rules that can benefit litigation funders and their clients are those that create a special incentive to sue—rules regarding damage enhancement, fee shifting, and simplified or lowered pleading requirements.\textsuperscript{176} This distinguishes plaintiffs' attorneys from defense attorneys:

Plaintiffs' attorneys are potentially interested in all products. In a given case, a defendant's attorney is interested in only one product and its history. Therefore, win or lose, the plaintiff's attorney is much more interested in the stated grounds of the decision than is the defendant. As long as the defendant wins, he does not care if the plaintiff obtains an opinion that greatly benefits other plaintiffs so long as it absolves the particular defendant. The plaintiff will fight very hard for such a decision, while the defendant will not resist much. Conversely, if the defendant loses, he does not care much if the rule is broad or narrow, but the plaintiff cares very much.\textsuperscript{177}

Therefore, investing in precedent is similar to investing in rule change via lobbying (and campaign contributions), a well-documented practice engaged in by the Plaintiffs' Bar.\textsuperscript{178} "Many trade associations, for example, have litigating arms as well as lobbying arms and sometimes use these to achieve legal change benefiting members."\textsuperscript{179} Further, investors' concentration in a

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\textsuperscript{175} Rubin & Bailey, The Role of Lawyers, supra note 8, at 808 (emphasis added).

\textsuperscript{176} For a discussion of special incentives to sue and rule changes that attempt to strengthen private enforcement, see generally Margaret H. Lemos, Special Incentives to Sue, 95 MINN. L. REV. 782 (2011).

\textsuperscript{177} Rubin & Bailey, The Role of Lawyers, supra note 8, at 810.

\textsuperscript{178} See, e.g., Rita Jameson, ATLA, TRIAL, July 1980, at 56, 59.

\textsuperscript{179} Bailey & Rubin, Legal Change, supra note 8, at 474. For example, the Association of Trial Lawyers of America "has also lobbied for or against federal legislation which might affect an injured party's receiving adequate awards . . . . Adequate representation of its viewpoints before Congress was one of the
limited number of legal subject matters is a form of specialization that may allow them to enhance the value of their portfolios rather than diminish it on account of a lack of diversification. Thus, the fact that litigation-finance firms’ portfolios appear, at first blush, to be invested in correlated risk may not pose a problem.

There is another reason why concentration along a very limited range of legal areas may not undermine the diversification rationale of portfolio management and why, consequently, investing in rule change may be valuable for financiers. Litigation-investment firms diversify along procedural characteristics of cases rather than subject matters. For example:

Burford Capital’s strategy is to create and manage a portfolio of commercial dispute financing investments diversified by duration, claim type, geography and a number of other variables, with the aim of providing shareholders with attractive levels of dividends and capital growth. The Company expects returns to be uncorrelated to general equity market performance.180

Other variables include the presence/absence of a jury, the particular judge, and the phase of the litigation (first instance or appeal).

In sum, while rule change is a public good and therefore the notion of commercial investors who are interested in profit maximization investing in it may seem counterintuitive, the argument advanced herein is that in certain circumstances, it is strategic for financiers to play for rules and that the public good of rule change is an externality of such strategic play.181

key reasons behind the association’s decision in 1977 to move its headquarters to Washington, DC.” Jameson, supra note 178, at 59.

180. Press Release, Burford Capital, supra note 19 (emphasis added); see also id. (“In the short term, the Company’s focus is on commercial disputes in the United States and on international arbitration matters; in the medium term, the Company may expand its focus to other attractive and suitable jurisdictions.”).

181. This is similar to Shavell’s point that the level of litigation is socially inadequate because litigants do not factor in the value of deterrence when they make their litigation decisions. Shavell, The Fundamental Divergence, supra note 8, at 609–10. His more general insight is that the general level of litigation is not optimal, but rather that the privately determined level of litigation can be either socially excessive or inadequate because of the fundamental differences between private and social incentives to use the legal system. Id. at 608–11. The divergence is attributable to two externalities. Id. at 611. First, when a party makes a litigation decision, it does not take into account the legal costs that it induces others to incur. The other externality is that the party does not recognize associated effects on deterrence and certain other social benefits. Id. It is argued herein that rule change/clarification is also a social benefit that parties do not factor in, which, in turn, may lead to a suboptimal
The claim, in other words, is a weak one. In a small yet socially significant number of cases, litigation funders will likely play for rules in order to maximize the future value of their (subject-matter-concentrated) portfolios. It is not a strong claim that investors will philanthropically or ideologically seek to advance the law via litigation as do nonprofit impact-litigation groups.182

The foregoing sections demonstrate how litigation funding can change the bargaining dynamics between types of litigating parties for the better. The following sections identify how this potential may be undercut by agency problems created by secondary markets in legal claims and the fragmentation of the attorney-client-funder relationship.

C. AGENCY PROBLEMS


Using the taxonomy as a prism highlights that different types of litigation funders may have different effects on bargaining dynamics between parties and, consequently, on different types of litigants' ability to play for rules. This is perhaps nowhere more stark than in relation to institutional investors. Unlike any of the other types of funders (plaintiffs' firms, with

level of trials. Litigation expenditures, according to Shavell, are subject to the same general divergence between private and social incentives so they may be in principle either socially excessive or socially inadequate. Id. at 610–11.

182. John Coffee recently suggested that nonprofit groups in Europe should join forces with litigation funders. Coffee, supra note 7, at 348–49. If this happens, financiers' role in rule change may become even stronger, though they will still be motivated by profit. Note, moreover, that it is not herein argued that financiers already do play for rules. The industry in the United States is young and too small to have established a track record of this sort. Rather, it is argued that this is a likely externality that will be created by this industry as it expands and matures. Additionally, this Article contends that funders that develop the reputation for playing for rules may gain a strategic advantage: opposing parties may have to factor into settlement offers the price that precedent creation/change may have on the funders on a portfolio basis. Finally, despite the aforesaid comments regarding the competitive bargaining advantage that may accrue to a litigation-finance firm that may deliberately play for rules, it is not necessary for the validity of the argument advanced herein that funders be deliberate and conscious of their social role in legal change. Rubin, for example, notes that "cases are more likely to be litigated and legal change is more likely to occur if parties with the stronger interest in a rule are disadvantaged by the current rule. This tendency towards change occurs as a natural result of the litigation process, with no requirement for conscious decisions." Bailey & Rubin, Legal Change, supra note 8, at 474 (emphasis added).
which they are conflated, and commercial funders, the original targets of the champerty doctrine), institutional investors may sell their investments in secondary markets. They may do so directly by bundling and securitizing legal claims or indirectly by selling shares in the investment firm itself. Parties thus may find themselves bargaining in the shadow of financing.\textsuperscript{183}

Secondary markets in legal claims have benefits. They can increase liquidity, lower the risk for funders, and lower the cost of finance for clients. Bargaining in the shadow of financing may also increase efficiency; institutional investors are in the process of developing due diligence protocols, standards, and statistics to assist in evaluating individual claims and making investment decisions across portfolios of cases.

But the shadow of financing further may alter bargaining dynamics by introducing additional agency problems and externalities. First, regulators, judges, and parties should consider the effects of indirect trading—trading in shares of public litigation investment firms. Perhaps the biggest risk this form of trading poses is that funders have fiduciary duties to the shareholders and not to clients. Unlike attorneys, who do have such duties towards the clients, funders only have contractual obligations. Therefore, a publicly traded funder must prioritize the interests of shareholders. That is, a funder must settle early for a low amount in order to realize shareholder gains in a given quarter rather than pursue a suit that is beneficial for the client but detrimental to shareholders. This conflict of interest may lead funders to pressure a client to settle early. An additional complication created by this form of trading is that it imposes disclosure duties on the funder. These duties could conflict with the desire of a party to keep certain strategic information confidential and could further undermine attorney-client privilege.\textsuperscript{184}

Second, one should consider the effects of direct trading—the prospect of trading in legal-claims-backed securities. This practice is not yet in existence but, as discussed above, precur-

\textsuperscript{183} Cf. Mnookin & Kornhauser, supra note 8, at 950 (coining the phrase “bargaining in the shadow of the law” to refer to negotiations that happen outside of the courtroom).

\textsuperscript{184} See, e.g., Binham, supra note 41 (“Juridica will target commercial litigations and international arbitrations for investment. But international arbitration is notoriously secretive: how to square that with AIM’s [a London stock exchange] disclosure rules? For that reason Travers Smith head of corporate finance Spencer Summerfield, who led the advice to the company on its float, admitted that Juridica’s ‘was the hardest IPO I’ve ever had to do.’”).
ors of such a practice already exist. In addition, given the significant difficulty of valuing any individual claim (i.e., the potential recovery in any given litigation), institutional investment in litigation finance may only be viable if those financing it can put together a large and diverse enough pool of cases—a portfolio.\textsuperscript{185} Once assets are pooled, securitizing and selling them off is a logical next step to consider.

Trading in legal-claims-backed securities can create moral hazards relating to both the funder-client relationship and the funder-investor relationships. On the funder-client side, in certain subject matters of litigation (e.g., a pure business dispute) the original owners of the litigation, unlike owners of homes or cars, may have a diminished interest in the asset underlying the security and a diminished incentive to prosecute their claims or defenses once the litigation ceases to be expensive and uncertain for them.

On the funder-investor side, as legal claims are commodified and ownership in them becomes freely transferable as part of an originate-and-distribute model,\textsuperscript{186} there is a risk of an asset bubble of the kind recently witnessed with novel assets like subprime mortgages.\textsuperscript{187} Such a bubble may form in a legal-

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\textsuperscript{185} See Kritzer, supra note 88, at 10–16 (explaining Kritzer’s application of portfolio theory to contingency fee firms). While securitization is probably not imminent in the current market, which is suffering from a rare lack of liquidity and where the rating agencies are unlikely to want to rate novel, hard-to-price securities, the difficulties valuating legal-claims-backed securities do not seem without parallel or insurmountable in the long run. On the current crisis in structured finance, and in particular on the breakdown of the rating agencies’ credibility, see generally Enhancing Investor Protection and the Regulation of Securities Markets: Hearing Before the S. Comm. on Banking, Hous., and Urban Affairs, 111th Cong. 64 (2009) (statement of John C. Coffee, Jr.) [hereinafter Hearing]. The difficulties in valuing legal claims and defenses render them an asset more similar to diamonds and art than to houses and cars. Nevertheless, it is asset classes of the former kind that some investors are showing an interest in because of, not despite of, the recent financial crisis. See William MacNamara, Moves to Mine Gem Potential, FIN. TIMES, Nov. 20, 2009, available at http://www.ft.com/cms/s/0/b29f69f4-d608-11de-b80f-00144feabdc0.html (discussing a recent, postcrisis push to create a diamond investment market in light of investors’ recent interest in alternative asset classes, despite the lack of transparency and liquidity in the diamond market, and the fact that diamonds are “terrifically difficult to value”). As Victor Goldberg pointed out to me, litigation as an asset class is similar to investing in start-up companies and films because the asset’s value depends on the effort the original owner makes after the investment has been made.

\textsuperscript{186} For a discussion of the originate-and-distribute model, its risks, and ways to curtail those risks, see generally Hearing, supra note 185, at 53.

\textsuperscript{187} See id.
claims market since the clients and the originators, or funders, will externalize the risks of faulty due diligence, poor legal judgment, or unzealous representation onto those holding the securities. As the recent financial crisis has demonstrated, when converging with other forms of risky securities, this can have deleterious effects on the economy as a whole. A bubble in the market for legal claims is also one scenario that does raise a significant risk of nonmeritorious claims flooding the courts—yet another externality on society as a whole. Moreover, trading in legal-claims-backed securities may add an additional layer of disclosure requirements on the funding firms, worsening the complications such requirements create for the client’s bargaining power, as discussed above.

Plaintiffs’ diminished control over their settlement negotiations, which may be exacerbated by secondary trading, and the obligation to maximize the bottom line for shareholders reveal another problem with litigation funding and claim transfer: the problem of commodifying legal claims. If legal claims are bought and sold, they become a pure commodity. As such, they simply are assigned a dollar value, have no other intrinsic value, and theoretically can be exchanged for any similarly valued commodity. While the literature is largely silent on why trading in legal claims is “distasteful,” the underlying sentiment may be resistance to the reduction of legal claims, particularly of nonbusiness legal claims, into a mere commodity.

Indeed, a unique, possibly socially undesirable, element to the commodification of legal claims is purely to monetize all legal recovery, thereby dramatically affecting choice of remedies. Nonmonetary remedies, such as injunctions, declaratory relief, and specific performance, become unattractive either because a plaintiff has lost interest or because the funder pressures for a simple monetary award instead of a socially desirable remedy such as injunction or clean-up. By acknowledging that the effects of litigation funding are different in different areas of law, the taxonomy allows for a nuanced consideration of the effects of commodification in different possible scenarios. Legislatures and courts should decide which litigation subject matters

188. See Dowd, supra note 98, at 142–44.
189. Herman, supra note 18 (“Detractors [of third party litigation funding] base their suspicion on . . . that there is something distasteful, some say unethical, about a third-party that has no involvement in a legal dispute being allowed to profit from it.”); see also WAYE, supra note 7, at 48.
190. WAYE, supra note 7, at 48.
should, as a matter of public policy, be subject to commodification and which should not.

U.S. tort law provides an example of the difficulty commodification poses. The United States allows the award of punitive damages—a quasi-criminal sanction—for certain torts. This is a manifestation of the public interest in prosecuting such claims to deter socially undesirable behaviors and economic activities such as pollution or the knowing distribution of damaged or hazardous goods. Conversely, in personal injury cases, we as a society have long accepted the notion of placing a dollar value on the economic aspect of bodily harm. Securities class actions are similarly straightforward in that the dollar value lost to the investor is the primary underlying harm. But more complex are antitrust class actions where the public has an interest in preventing anticompetitive behavior.

To further complicate matters, certain areas of law involve bundled interests, both monetary and nonmonetary, underlying large and complex legal claims. The solution, therefore, lies in courts unbundling the underlying interests and ensuring non-commodification of the underlying interests that as a society we wish not to commoditize. This can be done, as discussed in the next Part, by requiring court supervision or other safety measures be implemented in the settlement stage. It may also require, as discussed below, imposing certain fiduciary duties on the funder. Of course, this may mean that a plaintiff who seeks both monetary and nonmonetary remedies may have to allow for a larger percentage of the monetary recovery to be paid to the funder than would otherwise be the case.

A second problem, which may offset the potential positive effects of litigation finance, is the fragmentation of the triangular attorney-client-funder relationship. The relationship may break into two, or even three, separate relationships between attorney and client, funder and client, and in some cases attorney and funder. The next section will consider this issue.


2. The Fragmentation of the Attorney-Client-Funder Relationship

The complexity of the client-funder relationship has been the focus of much of the discussion of litigation funding. For example, commentators have noted that the introduction of a funder into the equation complicates a client's ability to communicate with her attorney and may diminish the attorney's ability to exercise professional judgment. The fragmentation of the attorney-client-funder relationship also stands to dilute the potential equalizing effects that litigation funding might have as amongst the litigating parties and therefore on one-shotters' and modified one-shotters' ability to affect rule change.

First and foremost is the question of client control and its effects on rule change. Beyond paying a monetary price, financed clients, especially one-shotters and modified one-shotters, will pay a price in the form of diminished control over their case—from choice of attorney to settlement. The argument against litigation funding based on the client's diminished control is, in essence, one of separation of ownership and control between the client and the funder (like the attorney in contingency cases). This is, however, a conceptual confusion that is caused by the tendency to treat third-party funding as identical to attorney funding, in which the party with the purse strings exerts undue control. But unlike the case of attorney funding, with litigation funding and claim transfer the client relinquishes full or partial ownership over its claim. (In fact, arguably, the attorney and client are now both agents of the

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194. See, e.g., WAYE, supra note 7, at 221.
195. For example, Vicki Waye in her book outlines and discusses two models of relationships between funders and claim holders. Id. at 221. Under the first, management of the proceeding is wholly delegated to the funder, and under the second, management of the proceedings is maintained by the client. Id. The categories of problems that may arise in both cases include agency problems of adverse selection, information asymmetry, and divergent goals. Id. at 222–26. Each of the three members of the triangular relationship may have different views on which strategies should be employed in the litigation, when and for how much to settle, whether the client can withdraw the lawsuit altogether, and whether the client or funder gets to pick counsel. Id. In the case of multiple claim holders, there are also fears of collusion between the attorney, defendant, and funder; potential free-rider problems; and possible conflicts of interest between class members. Id. at 221–67.
196. Repeat player clients, who may have an ongoing relationship with funders, may have more control than one-shotters and modified one-shotters, at least at the outset of litigation and over choice of attorney.
funder who co-owns part or the entire claim.) The law should acknowledge that the client relinquishes or should relinquish partial control over the litigation as it transfers partial ownership thereof. This, of course, should be factored into the pricing of the finance in favor of the client.

Even if one were to posit that something less than ownership is transferred, the case has already been powerfully made that diminished client control is acceptable in attorney-funded “entrepreneurial lawyering”—where the funder may seek out potential plaintiffs, take a pecuniary interest in the outcome, and act as private enforcer of the law. The case is doubly true for third-party funding which involves a commercial investor’s funding, which is entrepreneurial *par excellence*.

Beyond concerns relating to control and directly affecting the funded party’s bargaining position, fragmentation creates conflicts between an attorney’s interest to maximize fees and those of the financier to do the same. These divergent interests may lead one to settle early but the other to proceed to trial (depending on the role the case may have in their respective portfolios of cases and on the short-term interest of the principals). Similarly, if fee splitting is prohibited and the attorney receives a flat or hourly fee instead of a percentage of the recovery, the attorney has less incentive to properly vet a case as they transfer all risk to the funder. This moral hazard can increase if claims are then securitized and further distributed. While both attorneys and funders, as savvy repeat players, have an interest in creating and preserving reputational gains, this interest may pull them in different directions in any given litigation and may not be aligned with the client’s interest in, say, resolving a suit and moving on with her life.

Conflicts of interest are not the only complication. Client communication with the financier—who is likely to insist on such communications as a means of monitoring its investment—breaks the attorney-client privilege. But a lack of such communication creates information asymmetries between the attorney and the funder and lowers the funder’s ability to supervise the attorney’s work, supervision which may be bene-

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198. See discussion *supra* Part III.B.1.

199. See *Model Rules of Prof’l Conduct* R. 1.6 (describing the attorney-client privilege).
ficial for the client. More broadly, the potential to have an “agents-watching-agents” benefit is significantly reduced.  

When the financed party is a class or a corporation, or when the process in question is international arbitration, agency problems between the client, on the one hand, and the funder and attorney, on the other, may pose particular challenges. In these cases, the Class Action Bar, the Defense Bar, and the International Arbitration Bar, respectively, are populated by a finite set of repeat players. The funder-attorney relationships in these instances often may become repeat-play relationships. Consequently, here too are enhanced conflicts of interests between the client and both of its agents which results in less potential for the agents-watching-agents benefit.

In sum, litigation funding offers the potential of systemic benefits for litigants and for the civil justice system as a whole. But it is not a panacea of social justice or economic efficiency. The fragmentation of the attorney-client-funder relationship, with its consequent agency problems, diminishes the potential benefits litigation funding may entail from a bargaining perspective. It is these complications that should be the focus of regulatory efforts. The same is true of the concerns arising from the prospect of secondary markets and underlying champerty that are relevant to the contemporary economic landscape and to litigation finance under the taxonomy above. Regulators, legislators, the courts, and the parties negotiating funding contracts should take into account the above-described agency problems in the different categories of litigations to efficiently manage litigation finance. The next Part offers a conceptual framework to develop such regulatory measures and contract devices.

IV. IMPLICATIONS FOR REFORM: REGULATION OF LITIGATION FINANCE

As we have seen, a hard and fast prohibition is undesirable and unnecessary. In other areas of the law where similar concerns arise, mechanisms have been developed to ameliorate

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200. Developed in the context of institutional shareholders' monitoring corporate managers, the concept of "agents watching agents" involves situations where the self-interests of one set of agents involves monitoring other agents, who have a different set of self-interests which, in turn, may conflict with the interests of the principals. See Bernard S. Black, Agents Watching Agents: The Promise of Institutional Investor Voice, 39 UCLA L. REV. 811, 850 (1992).

201. See discussion supra Part III.B.1–2.
them and to allow the similar practices. In the case of litigation funding, the risks involved are overwhelmed by two major benefits. One is the increased access to justice. The other is that litigation finance helps align the bargaining power of different categories of litigants and gives previously excluded categories (e.g., "one-shotters" and modified "one-shotters") a chance to play for rule change as modified repeat players. That, however, does not mean that litigation finance should be left unchecked. Litigation funding transforms fundamental socioeconomic relationships—among clients, attorneys, and the investing public—in ways that this Article only begins to outline. More will be learned as the industry matures and expands, as challenges to it are brought, as courts opine on it, and as more scholars put their heads together to contemplate this watershed development.

The following reform recommendations, therefore, are not intended to be an exhaustive list. Rather, they are intended as a conceptual framework for regulation aimed at maximizing the benefits and minimizing the difficulties inherent in litigation funding. While the suggested measures can go a long way towards strengthening the client's legal and bargaining positions vis-à-vis the funder and providing the client with redress in case a funder breaches its duties, they will not eliminate the underlying problems. In other words, the funder-client relationship, like the attorney-client relationship, can create a form of entrepreneurial litigation where the social benefit of allowing the relationship, with all of its shortcomings, outweighs the costs.

The elements of the suggested regulatory framework are as follows: (1) eliminate the champerty prohibition, at least as it relates to litigation funding; (2) reform the attorney-client-funder relationship, including by extending some of the protections and duties of the attorney-client relationship to the funder-client relationship, by limiting the prohibition on fee sharing to allow attorneys to contract directly with the funders, and allowing and encouraging fee structures that align the three parties' interests; (3) apply consumer-protection and contract-design principles to funding agreements; (4) require court supervision over the attorney-client-funder arrangements; and (5) tailor securities regulation to legal-claims-backed securities.

202. See supra Part III.B.
A. ELIMINATING THE CHAMPERTY RESTRICTION AS IT RELATES TO THIRD-PARTY LITIGATION FUNDING

We have seen that the policy grounds for the champerty prohibition include a desire to discourage frivolous litigation, fear of unfair dealing by Great Men, fear of permitting lay persons to engage in the unauthorized practice of law, fear that funding arrangements will harm the clients by creating conflicts of interest and will threaten the independence of lawyer's professional judgment, fear that attorneys or clients could share confidential information with the third party, and finally that third parties could effectively control litigation.

Some of these concerns, like the fear of a deluge of nonmeritorious claims are, at the very least, greatly exaggerated. Litigation finance does not eliminate litigation costs; it shifts them to the funder (and distributes them in a secondary market in legal claims). A commercial funder needs to make a rational economic decision to invest in a claim. It would not do so if the claim does not have merit and is unlikely to succeed. The immediate conclusion from the analysis in Part III is, similarly, that elimination of the champerty prohibition, at least as it relates to the litigation-funding context, will increase access to justice and equal participation in the judicial process. A modernization of champerty laws can be achieved via legislative means (as in Australia and the United Kingdom) or by judicial development of the doctrine (as in some states).

B. REFORMING THE ATTORNEY-CLIENT-FUNDER RELATIONSHIP

The first and possibly most radical recommendation regarding this relationship is that some of the protections and duties of the attorney-client relationship be expanded to en-
compass funders. Coupled with transparency requirements pertaining to the funder-attorney relationship (discussed below), this measure will help to minimize conflicts of interest between both agents and the client, reduce information asymmetries between the attorneys and the funder, and protect the client's ability to communicate freely with her attorney. Perhaps most critically, this element can contribute most to strengthening the client's position vis-à-vis the funder, minimizing the conflicts of interest and moral hazards discussed in Part III and enhancing client control over the litigation. For example, a fiduciary duty on the part of the funder toward the client can improve the client's position vis-à-vis the funder's shareholders where the funder has to navigate potentially competing interests. The funder's fiduciary duties can also increase the client's bargaining position regarding nonmonetary remedies, diminishing the problem of commodification.

The key protections of the attorney-client relationship are the confidentiality of attorney-client communications and the protection of attorney work product. If these are extended to communications with the funder, one of the key impediments to effective third-party funding will be removed. This may also lower the cost of financing to clients as funders will have more information about their investment and, therefore, more certainty as to its value. This extension can be achieved doctrinally, either by extending the common interest doctrine or by viewing both the client and the funder as co-clients, in the same manner as these solutions have been devised and applied in the insurance context.

With privilege comes obligation: funders should be deemed fiduciaries of the client. Fiduciary duties—especially those ap-

206. See Model Rules of Prof'L Conduct R.1.6 (2010).
207. Id., cmt. 3.
plied to attorneys, namely, the common-law duties of loyalty and of zeal—should therefore be applied to funders. This should go a long way towards addressing conflicts of interest between the funder and the client and enabling a higher measure of client control. For example, once a funder is viewed as a fiduciary of the client, and must therefore take into account the best interests of the client, the funder will have to consider whether nonmonetary remedies better serve the client than do mere monetary damages. Similarly, when considering settlement offers, funders will have to take into account the interests of the client and not only their own interests. Funders will have to disclose potential conflicts across their portfolio of investments and will have to seek informed consent for conflicts. Certain categories of conflicts will be deemed unwaivable just as they are in the attorney-client relationship.

A closely related recommendation is to allow and encourage fee structures that align the interests of both the funder and the attorney with those of the client’s. For example, hybrid fees can be devised that include either a reduced hourly rate or a flat fee for the attorney’s services, on the one hand, and a performance bonus or a reduced percentage of the recovery, on the other. Such an arrangement will incentivize lawyers to invest in the litigation, will reduce the rush to settle and enhance the attorney’s position, as a party with a contingent interest, vis-à-vis the funder. This, in turn, will help preserve the attor-


210. Compare MODEL RULES OF PROF’L CONDUCT R. 1.2 cmt. 1–2 (2010) (“[Rule 1.2] confers upon the client the ultimate authority to determine the purposes to be served by legal representation, within the limits imposed by law and the lawyer’s professional obligations.”), with DOBBYN, supra note 104, at 359–60, 366 (describing insurers’ general duty to defend even when the charge does not include an obligation to pay proceeds).


212. Id. R. 1.8.

213. See id. R. 1.7 (2010) (discussing when a lawyer can and cannot represent a potential client due to conflicts of interest).

214. Coffee suggests that “[t]he conventional wisdom about large contingent fees is that they can motivate the attorney to settle prematurely[.] . . . [b]ut if the attorney were paid on a non-contingent basis, the attorney would have little, if any, incentive to settle early . . . . Hence the attorney’s self-interest would counterbalance those of the litigation funder.” Coffee, supra note 7, at 342.
ney’s independent professional judgment and create counter-leverage to the funder’s bargaining position.

In order for these recommendations to work, attorneys should be allowed to contract directly with funders. Attorneys and funders should both be required to fully disclose this arrangement to the client. Reformers can also require that leave of the court be granted to funders and attorneys wishing to enter into such fee sharing arrangements, as discussed below. This will require loosening the prohibition on fee splitting in the litigation finance context or liberalizing the rules on multidisciplinary practices.\textsuperscript{215}

C. COURT SUPERVISION

Court supervision similar to that required in the class action context should also be considered.\textsuperscript{216} In addition to court supervision of any attorney-funder fee agreement, courts may also oversee the financing agreement between the funder and the client. For example, legislators may require that leave of the court be obtained before entering such an agreement. Court review may include setting a cap on the proportion of the award that funders and attorneys (individually and collectively) can claim, as well as consideration of the incentives set by any fee-splitting arrangements. Courts can also scrutinize and approve the terms of settlements.\textsuperscript{217}

\textsuperscript{215} See supra note 54 and accompanying text (discussing multidisciplinary practice).

\textsuperscript{216} See FED. R. CIV. P. 23; Jean R. Sternlight, As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?, 42 WM. & MARY L. REV. 1, 33 (2000) (discussing Federal Rule of Civil Procedure 23, which provides the basis for court supervisory powers over class actions: "Rule 23 builds protective measures directly into its provisions, not only by requiring the court to certify the class, but also by allowing the court to divide a class into subclasses where appropriate, to mandate notice to class members, to require opportunities be afforded for directly participating in the action, and to approve or disapprove any settlement that is reached in a class action.").

\textsuperscript{217} Judicial review of contingency fees, class actions settlements, and bankruptcy fees is quite common. See Lindy Bros. Builders, Inc. v. Am. Radiator & Standard Sanitary Corp., 487 F.2d 161 (3d Cir. 1973) (establishing the "lodestar standard"), vacated, 540 F.2d 102 (3d Cir. 1976). See generally Macey & Miller, supra note 164 (analyzing court standards of review for class action settlements). Bankruptcy law, in particular, grants courts broad supervisory powers. See, e.g., N. Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 55 (1982) (noting the extensive powers provided by 11 U.S.C. § 105(a) (2006), which provides federal bankruptcy courts the power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [this title]").
Courts also may wish to scrutinize, ex ante or when a challenge is raised, the terms of the funder-client and funder-attorney contracts as a whole.\textsuperscript{218} Legislators or courts can develop criteria against which judges can assess whether a funding arrangement is contrary to public policy. Such considerations may include the following: the taxonomy of the client, process, and area of law in question; whether there is a fee-splitting agreement between the funder and attorney and, if so, what kind of incentive structure it sets up; whether the attorney was chosen by the client or by the funder; the sophistication of the client and whether she was assisted by counsel in her negotiation of the funding agreement; whether adequate disclosures were made to the client by the funder and the attorney; whether the client is in a position to make informed decisions regarding the conduct of proceedings; and whether independent advice is reasonably available to the client.\textsuperscript{219}

D. THE FUNDING CONTRACT: CONTRACT DESIGN AND CONSUMER PROTECTION

It should be noted that the current prohibition on litigation funding is a limitation on the freedom of contract.\textsuperscript{220} However, the particular problems posed by the funder-client relationship affect the public interest in the judicial system and the economy as a whole. Thus, litigation funding contracts should be subject to the same analysis and protections afforded in other areas where consumer protection is heightened.

As noted before, the funding contract can be viewed either as a financing agreement on the plaintiff's side or like an in-

\textsuperscript{218} Compare Sternlight, supra note 216, 32–33 (discussing the breadth of court supervision in class action cases), with STANDING COMM. OF THE ATTORNEYS-GEN., supra note 109, at 12 (describing the Australian bankruptcy scheme which gave rise to the entire field of third-party funding: “Currently, liquidators are obliged to obtain court approval for litigation funding contracts, if the matter may be resolved more than 3 months after the agreement is entered into. This means that effectively all litigation funding agreements made by liquidators are vetted by the courts . . . . Greater transparency might also lead to improved competition in the legal services and litigation funding markets, perhaps resulting in lower pricing.”).

\textsuperscript{219} STANDING COMM. OF THE ATTORNEYS-GEN., supra note 109, at 11 (discussing factual scenarios that have come up in Australian jurisprudence). Australia has seen more than twenty challenges to funding arrangements. None of the challenged contracts have been struck down, though some cases were stayed until the funder and the attorney could revise the contracts. \textit{Id.} at 4.

\textsuperscript{220} See supra Part II.B. (discussing the current limitations on litigation financing).
surance agreement on the defense side. Regulators, legislators, and the bench are therefore advised to draw on the design and regulation paradigms of both (retail) finance contracts and insurance contracts when addressing litigation funding. Parties and the attorneys representing them are also advised to take into consideration contract design theory when negotiating such agreements.

1. Contract Design

Given the similarities between the concerns governing insurance agreements and funding agreements, one can adapt the measures developed in the former context to the latter. Insurance contracts typically include moral hazard clauses aimed at preventing fraud and collusion against the insurer by allowing the insurer to deny coverage in such circumstances. These include, for example, record-keeping clauses which require insureds to keep records that insurers can later inspect to evaluate a claim. Similar obligations can be contractually imposed on litigants seeking funding. This will disincentivize misrepresentations and better align the interests of the client and the funder even after the risk transfer has occurred. Similarly, co-payment, co-insurance arrangements, and deductibles are used as protection against moral hazards ensuring that the insured has an interest in remaining actively involved in her defense.

In order to deal with conflicts of interest, insurance law also recognizes certain defenses for insurers. The defense of concealment places an affirmative duty on insureds to disclose all material facts, the defenses of representations and warranties cover express or implied statements made by the insured.

221. DOBBYN, supra note 104, at 172.
222. Id.
223. See Molot, supra note 7, at 375 ("[Defendant] could choose to pay the 'expected value' of its lawsuit plus a premium to protect against a higher-than-expected loss. After making such a payment, the litigant would still retain at least some of the risk, so as to align incentives and ensure its cooperation going forward. But the risk of protracted, expensive litigation and of a devastating judgment would no longer be concentrated with the single defendant."). See generally Thomas A. Smith, Institutions and Entrepreneurs in American Corporate Finance, 85 CALIF. L. REV. 1 (1997) (discussing the role of institutional investors in protecting customers from risk).
224. DOBBYN, supra note 104, at 286–87.
and relied on by the insurer, and limitations and exceptions restrict coverage. Courts can draw on these doctrines by way of analogy when engaged in contract interpretation of a funding agreement.

The insurer’s corresponding duties include an obligation to defend any action brought against the insured on any cause of action that falls within the policy coverage, even when the action may not entail an obligation to pay proceeds. In order to be able to effectively defend an action, insurance law imposes on an insured the duty to cooperate with the insurer. This includes the duty to attend depositions, hearings, and trial, and to assist in settlement negotiations and in obtaining evidence. All these make the duty easily applicable to the funder-client context where, without such a duty, a moral hazard may arise in the form of the client having a diminished interest in participating in the prosecution or defense of her case. Importantly, the insurer’s responsibility for the defense also affords it the right to control the litigation, though insurer’s generally permit private counsel of the insured to advise and often employ outside counsel with obligations to the client. The insurer may also negotiate and control settlement.

The imposition of some fiduciary duties to ameliorate a range of concerns suggested above is also familiar to insurance law. Courts frequently impose on insurers a duty of acting with reasonable care in performing their obligation to defend. Courts have also devised a bad faith cause of action in insurance contracts aimed at addressing the particular conflicts of interest inherent in settlement negotiations. Similar to co-
licts in the funding context, an insured may have an interest to settle for the maximum amount covered by the policy, but an insurer may have an interest to go to trial and possibly get an award for a lower sum at the risk of getting an award for a sum higher than the policy limits.\textsuperscript{233}

In certain relatively limited circumstances, insurance law imposes on the insurer a duty to hire independent counsel for the insured.\textsuperscript{234} Some litigation funders are incorporating similar provisions. These provide for an independent counselor to advise the client regarding settlement offers.\textsuperscript{235}

2. Consumer Protection: The Insurance Analogy and Finance Regulation

As noted, insurance regulation and financial regulation are applicable indirectly and directly, respectively. And both include consumer-protection obligations, which can be incorporated in the regulation of litigation funding. First are capitalization requirements: obligations with regard to the issuer’s or insurer’s (and thus a funder’s) financial status.\textsuperscript{236} These are often coupled with reporting requirements requiring the filing of annual (and quarterly, in the case of issuers) statements with regulators.\textsuperscript{237} Second are disclosure requirements and informed consent: duties to disclose to the client the risks and benefits of the arrangements including fees, commissions, and all other significant features of the proposed agreements.\textsuperscript{238} Disclosure requirements can also encompass funder’s possible conflicts of interest, funder’s financial ability to provide the funding pledged, the funder’s intention to securitize or otherwise sell its

\textsuperscript{233} Id.  
\textsuperscript{234} San Diego Navy Federal Credit Union v. Cumis Insurance Society, Inc. is the leading case on conflicts of interest in the triangular relationship between insurer, insured, and attorney. 208 Cal. Rptr. 494, 496 (Ct. App. 1984) (holding that where the insured and the insurer have conflicting interests the insurer must pay the reasonable cost for hiring independent counsel by the insured).  
\textsuperscript{235} Interview with Anonymous, Exec., Undisclosed Inv. Firm (Nov. 2009).  
\textsuperscript{236} STANDING COMM. OF THE ATTORNEYS-GEN., supra note 109, at 8 (describing the imposition of disclosure duties regarding capitalization requirements on Australian litigation funders).  
\textsuperscript{237} BAKER, supra note 101, at 22 (describing state reporting requirements).  
rights in a funded litigation, and any agreement between the funder and the attorney. Third are standard form requirements, which may include developing and making available model financing contracts and provisions.\textsuperscript{239}

Of course, if securitization of legal-claims-backed securities are developed and sold to the public, the existing protections of securities law will become applicable. These protections involve detailed registration, reporting, and disclosure requirements about the issuing entity and all material characteristics of the asset pool and selection criteria.\textsuperscript{240}

The discussion of how best to regulate a secondary market in legal claims would benefit from the discourse on the reform of securities regulation in light of the recent financial crisis. Measures contemplated as part of the current discourse on legal reform of the securities industry and aimed at curtailing the moral hazard involved in the originate-and-distribute model can be imposed on issuers of legal-claims-backed securities whether or not they are adopted more widely.\textsuperscript{241} Such measures may include: the reintroduction of tighter standards for due diligence conducted by independent due diligence firms; requiring issuers, like litigation finance firms, to hold on to an adequate portion of the subordinated tranche of legal-claims-backed securities (representing the riskiest assets); and denying the ability to hedge risk on the subordinated tranche.\textsuperscript{242} The attention being paid to models of valuation and rating could help defuse the tension between the disclosure requirements imposed by securities regulation and the confidentiality requirements in international arbitration, and the difficulty in valuing and, therefore, of rating such securities.

Furthermore, the attorneys involved in the triangular attorney-client-funder relationship at any rate must conduct due

\textsuperscript{239} BAKER, supra note 101, at 38–39 (describing the use of standard form agreements in insurance law); see also Larry Catá Backer, From Moral Obligation to International Law: Disclosure Systems, Markets, and the Regulation of Multinational Corporations, 39 GEO. J. INT’L L. 591, 630 (2008) (“Regimes of financial reporting and disclosure are basic to the regulatory regimes of virtually every state.”).


\textsuperscript{241} See Hearing, supra note 185, at 53–54.

\textsuperscript{242} See generally id. at 51–67 (discussing the desirability of such reforms).
diligence of the legal claims.\textsuperscript{243} Since their role is already understood to diverge from the pure attorney-as-advocate role, one can contemplate structuring that role so as to utilize the attorneys as gatekeepers.\textsuperscript{244} They would monitor the financier in its capacity as issuer and dissuade it from reckless practices.\textsuperscript{245}

CONCLUSION

Reflecting back on the examples in the opening of this Article, we can now see how moving from prohibition of litigation funding to its regulation can be beneficial both to litigating parties and to society as a whole. It enables reaping the benefits of enhanced access to justice and private enforcement of the law while minimizing the concerning side effects of allowing a third party to fund litigation. The first example illustrated the notion that individual plaintiffs with (potentially) meritorious claims that they nonetheless cannot afford to prosecute may use third-party support to go up against even the most powerful of defendants—the President of the United States. It also illustrated the need for regulatory mechanisms, such as court supervision of funded litigations, to prevent abuse and subversion of the court system for political ends.

The next example envisioned villagers suffering environmental harms and human rights abuses by a multinational corporation based in the United States. Physically remote, poor, and living within a compromised legal system, the Angolan villagers would have little chance of vindicating their rights against the corporation that injured them. With litigation funding, however, the villagers and other plaintiffs like them would not only gain access to U.S. courts, but would be able to litigate without having to settle at a discount. In the process, they would promote not only private enforcement of environmental and human rights standards, but also engage in rule change in areas where the funder may have a similar, or even greater, incentive than the plaintiffs to play for rules. Regulations impos-


\textsuperscript{244} Id.

\textsuperscript{245} See id. at 192 (2006) (arguing that at the wake of the corporate scandals of the early 2000s that corporate attorneys can and should serve as "gatekeepers," not only as advocates, to assist in preventing corporate fraud); Molot, supra note 7, at 376 (advocating that the attorney in the litigation-finance context be viewed as a broker of litigation-finance services).
ing, among other things, a form of fiduciary duty on the funder toward the plaintiffs would limit the chances that the latter’s interests were steamrolled.

The third example involved a corporation purchasing after-the-event insurance against a major class action allowing it to continue its operations, raise capital, and engage in major transactions while the litigation is ongoing. Under the suggested regime, a primary market for such insurance will be available and secondary markets might even lower the price of such insurance. The moral hazard that this type of insurance may create will be minimized through the devices detailed in Part IV and also due to the fact that the company will be operating in a landscape in which its opposing parties may now be more formidable given their own access to funding.

Next, the reader was invited to imagine an oil company funding a developing country’s defense of a boundary dispute. Without such funding, the sovereign might find itself unable to mount a sophisticated defense of a serious, albeit peaceful, threat to its physical integrity. The concerns—among them, a potential conflict of interest between an oil company concerned with securing its fields and a country concerned with the much larger issues of its borders—conjured up by such a scenario can be addressed through the reporting and licensing requirements and disclosure rules. These all will help shed light on such a relationship allowing for public scrutiny. Similarly, a regulated, transparent, and competitive litigation-finance industry would provide the sovereign in question with alternative funding sources. The sovereign would now be able to comparison shop for the best available financing terms, both in terms of strings attached and in terms of price. The developing nation would still gain access to sophisticated counsel and reap the rewards of rule change, in the form of boundary delineation, without having to cede control to an entity that is not a party to the litigation, but that may have an interest in its subject matter.

The final example invoked the specter of China’s Sovereign Wealth Fund gleaning, as a litigation funder, proprietary information retained by an American company regarding sensitive technologies. Applying a nuanced analysis based on the taxonomy would allow us to determine that a narrowly defined, subject-matter-specific prohibition relating to national security may be an appropriate response that does not hamper the ability to retain litigation finance for matters that are not of national security concern. Alternatively, funding may be permitted
with restrictions on abuse of the discovery process, currently imposed on attorneys, extended to the funders of the attorney-client-funder relationship.

All of this is not to idealize litigation finance. The elaborate regulatory regime envisioned in Part IV, the cautionary note to parties and their attorneys regarding the need for careful contract design, and the analogies to the heavily regulated insurance and finance industries are meant to acknowledge the complexities involved in moving away from a prohibition responsibly. However, the aim of this Article is to suggest that litigation finance is an industry whose time has come. Third-party financing of litigation will increase access to justice and encourage private enforcement of the law. It will eliminate a market failure plaguing corporate America: the inability of corporations to efficiently manage the risk of litigation. Most important, however, litigation funding will reduce systemic inequalities in our legal system by altering the bargaining positions of individual, class, and sovereign plaintiffs and corporate defendants in a way that will increase the equality of arms in any given litigation and make it more likely that more kinds of litigants will be able to play for rules. This is the coveted change at the level of parties that scholars of litigation equality have long advocated. Unlike other suggested large-scale reforms, it is politically viable because it benefits both plaintiffs and defendants. So, whose claim is this anyway? With careful management, any meritorious claim irrespective of the social position of the party in question.